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EDITOR'S NOTE

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No. 86-753-ASX          Title:  Richard Pennell and Tri-County Apartment House
Status: GRANTED                 Owners Association, Appellants
                                v.
                                City of San Jose and City Council of San Jose
Docketed:
November 7, 1986        Court:  Supreme Court of California

See also:               Counsel for appellant: Miller,Harry D.
    86-1502
                        Counsel for appellee: Gallo,Joan R.


Entry    Date     Note                 Proceedings and Orders
-------------------------------------------------------------------------------

  1    Nov  7 1986 G Statement as to jurisdiction filed.
  3    Nov 24 1986         Order extending time to file response to jurisdictional
                           statement until December 30, 1986.
  4    Dec 19 1986 G       Motion of California Association of Realtors for leave
                           to file a brief as amicus curiae filed.
  5    Dec 27 1986 G       Motion of Pacific Legal Foundation for leave to file a
                           brief as amicus curiae filed.
  6    Jan  2 1987   Motion of appellees City of San Jose, et al. to dismiss or
                           affirm filed.
  7    Dec 19 1986 G       Motion of California Apartment Association for leave to
                           file a brief as amicus curiae filed.
  8    Jan  7 1987         DISTRIBUTED. January 23, 1987
  9    Jan 21 1987         Record requested.
 10    Feb 10 1987         Record filed.
 11    Feb 11 1987         REDISTRIBUTED. February 27, 1987
 12    Mar  2 1987         Motion of California Association of Realtors for leave
                           to file a brief as amicus curiae GRANTED.
 13    Mar  2 1987         Motion of Pacific Legal Foundation for leave to file a
                           brief as amicus curiae GRANTED.
 14    Mar  2 1987         Motion of California Apartment Association for leave to
                           file a brief as amicus curiae GRANTED.
 15    Mar  2 1987         Further consideration of the question of jurisdiction is
                           POSTPONED to the hearing of the case on the merits.
                           ***********************************************************
 17    Mar 17 1987         Order extending time to file brief of appellant on the
                           merits until May 18, 1987.
 18    May 13 1987   Brief amicus curiae of Rent Stabilization Assoc. of New
                           York, et al. filed.
 19    May 18 1987   Brief amicus curiae of Competitive Enterprise Inst. filed.
 20    May 18 1987   Brief amicus curiae of National Assoc. of Home Builders, et
                           al. filed.
 21    May 18 1987   Brief amicus curiae of Washington Legal Foundation filed.
 22    May 19 1987   Joint appendix filed.
 23    May 19 1987   Brief of appellants Richard Pennell, et al. filed.
 24    May 18 1987   Brief amicus curiae of National Multi Housing Council filed.
 25    May 19 1987        Order extending time to file brief of appellee on the
                          merits until July 31, 1987.
 27    May 18 1987   Brief amicus curiae of California Apartment Assn., et al.
                          filed.
 28    May 18 1987   Brief amicus curiae of California Association of Realtors
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Entry	Date	Note	Proceedings and Orders
			filed.
29	May 18 1987		Brief amicus curiae of Natl. Assn. of Realtors filed.
30	Jul 31 1987		Brief amicus curiae of Legal Aid Society of Santa Clara County, et al. filed.
31	Jul 31 1987		Brief amicus curiae of National Institute of Municipal Law Officers filed.
32	Jul 31 1987		Brief amicus curiae of AFL/CIO filed.
33	Jul 31 1987		Brief of appellee City of San Jose filed.
34	Jul 31 1987		Brief amicus curiae of National Housing Law Project filed.
35	Jul 31 1987		Brief amicus curiae of ACLU and ACLU of Southern CA filed.
36	Jul 31 1987		Brief amicus curiae of Center for Constitutional Rights filed.
37	Jul 31 1987		Brief amicus curiae of City of Santa Monica, et al. filed.
38	Jul 31 1987		Brief amicus curiae of US Conference of Mayors et al. filed.
39	Aug 3 1987		Lodging received.
40	Aug 13 1987		CIRCULATED.
41	Aug 31 1987		SET FOR ARGUMENT. Tuesday, November 10, 1987. (1st case).
42	Oct 1 1987		Application of appellants for leave to file a reply brief in excess of the page limitation filed (A-277),
43	Oct 1 1987		and order denying same by O'Connor, J., on October 7, 1987.
44	Oct 29 1987	X	Reply brief of appellants Richard Pennell, et al. filed.
45	Nov 10 1987		ARGUED.

JURISDICTIONAL
STATEMENT

86-759 ①

Supreme Court, U.S.
FILED
NOV 7 1986
JOSEPH F. SPANIOL, JR.
CLERK

No.

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1986

RICHARD PENNELL and
TRI-COUNTY APARTMENT HOUSE OWNERS ASSOCIATION,
Appellants,

VS.

CITY OF SAN JOSE and CITY COUNCIL OF
THE CITY OF SAN JOSE,
Appellees.

On Appeal from the Supreme Court of the State of California

JURISDICTIONAL STATEMENT

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10 M

QUESTION PRESENTED FOR REVIEW

Are municipal rent regulations that compel individual property owners to subsidize the welfare of low income tenants by prohibiting rental increases because of an individual tenant's economic hardship repugnant to the just compensation, due process or equal protection clauses of the Fifth and Fourteenth Amendments?

PARTIES TO THIS APPEAL

The parties in this case are Appellants, Richard Pennell and Tri-County Apartment House Owners Association, who were plaintiffs, respondents and cross-appellants in the lower courts and Appellees, City of San Jose and City Council of the City of San Jose who were defendants, appellants and cross-respondents in the lower courts.

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No.

In the Supreme Court
OF THE
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OCTOBER TERM, 1986

RICHARD PENNELL and
TRI-COUNTY APARTMENT HOUSE OWNERS ASSOCIATION,
Appellants,

vs.

CITY OF SAN JOSE and CITY COUNCIL OF
THE CITY OF SAN JOSE,
Appellees.

On Appeal from the Supreme Court of the State of California

JURISDICTIONAL STATEMENT

Appellants Richard Pennell and Tri-County Apartment House Owners Association submit their jurisdictional statement and respectfully request that probable jurisdiction be noted.[1]

OPINIONS BELOW

The opinion of the California Supreme Court is cited as *Richard Pennell, et al. v. City of San Jose,* 42 Cal.3d 365 (1986), and appears as Appendix A. The opinion of the California Court of Appeal was cited (until vacated) as *Richard Pennell, et al. v.*

---

[1] Alternatively, Appellants respectfully request that this jurisdictional statement be treated as a petition for writ of certiorari, and granted. 28 U.S.C. section 2103.

City of San Jose, 154 Cal.App.3d 1019, 210 Cal. Rptr. 728 (1984), and appears as Appendix B. The judgment of the California Superior Court appears as Appendix C.

JURISDICTIONAL BASIS

The California Supreme Court filed its opinion in this case on August 11, 1986, reversing the judgment for Appellants in the Superior Court that had been affirmed by the California Court of Appeal. Appellants filed a Notice of Appeal to this Court on October 29, 1986.[2] This Court has jurisdiction of this appeal under 28 U.S.C. § 1257(2), which provides for an appeal from a final judgment of a state's highest court "where is drawn in question the validity of a statute of any state on the ground of its being repugnant to the Constitution . . . and the decision is in favor of its validity." Section 1257(2) applies where a municipal ordinance has been declared constitutional by a state's highest court. *Erznoznik v. City of Jacksonville,* 422 U.S. 205, 207 n. 3 (1975).

RELEVANT CONSTITUTIONAL AND STATUTORY PROVISIONS

The relevant Constitutional provisions involved in this appeal are:

Fifth Amendment, Section 1:

> No person shall be . . . deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

Fourteenth Amendment, Section 1:

> No State shall . . . deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

---

[2] A copy of the Notice of Appeal appears as Appendix D.

The relevant statutory provisions involved in this appeal are:

The San Jose Rental Dispute Mediation and Arbitration Ordinance, San Jose Municipal Ordinance 19696 (the "Subject Ordinance") which appears as Appendix E. The pertinent portions of the Subject Ordinance are:

> § 5703.28(c): When the amount of any rent increase or portion thereof exceeds any of the foregoing standards under subsections (a) or (b) of this Section, the Hearing Officer shall determine what is reasonable under the circumstances taking into account any of the following factors on which he has received information:
>
> > (1) In the case of increased costs of debt service due to a sale or refinancing of the rental units or the building or property of which the units are a part within twelve (12) months of the increase: (i) the arms length nature of the transaction, (ii) the landlord's rate of return on the investment, (iii) the frequency of past resale or refinances, and (iv) the extent to which prior rental increases have made provisions for appreciation of asset value;
> >
> > (2) the rental history of the unit or the complex of which it is a part, including: (i) the presence or absence of past increases, (ii) the frequency of past rent increases, (iii) the landlord's response to Proposition 13 savings, and (iv) the occupancy rate of the complex in comparision to comparable units in the same general area;
> >
> > (3) the physical condition of the rental unit or complex of which it is a part, including the quantity and quality of maintenance and repairs performed during the last twelve (12) months;
> >
> > (4) any increases or reductions of housing services since the last rental increase before the effective date of this Ordinance;
> >
> > (5) other financial information which the landlord is willing to provide;

> (6) existing market value of rents for units similarly situated;
>
> (7) the hardship to a tenant, as provided in Section 5703.29.
>
> § 5703.29: . . . [T]he Hearing Officer shall consider the economic and financial hardship imposed on the present tenant or tenants . . . Any tenant whose household income and monthly housing expense meets the criteria established by the Housing Assistance Payments Program under Section 8, existing housing provisions of the Housing and Community Development Act of 1974 (P.L. 93-383) and the regulations pertaining thereto, shall be deemed to be suffering under financial and economic hardship which must be weighed in the Hearing Officer's determination.

STATEMENT OF THE CASE

The City Council of the City of San Jose adopted San Jose Municipal Ordinance 19696, entitled the "San Jose Rental Dispute Mediation and Arbitration Ordinance" (the "Subject Ordinance") on July 10, 1979. The stated purpose of the Subject Ordinance is:

> "to alleviate some of the more immediate needs created by San Jose's housing situation. These needs include but are not limited to prevention of excessive and unreasonable rent increases, the alleviation of undue hardship upon individual tenants, and the assurance to landlords of a fair and reasonable return on the value of their property." Section 5701.2.[3]

The Subject Ordinance establishes a mechanism under which tenants can challenge the reasonableness of rental increases that exceed in any twelve-month period, the greater of 8% or the amount of certain specified cost or debt service pass throughs. Section 5703.28(c) lists seven factors for consideration by hearing officers in the determination of the reasonableness of challenged rental increases. The first five factors involve the income, expenses and condition of the rental property involved, and the sixth is market value of comparable rents. The seventh is the economic or financial hardship to the tenant or tenants of the rental unit or units involved. Tenants qualifying under the criteria established by the Housing Assistance Payments Program under Section 8 of the Housing and Community Development Act of 1974 (P.L. 93-383) are deemed *automatically* to be suffering under financial and economic hardship which *must* be weighed in the hearing process.[4]

Appellants, who are owners and operators of residential rental properties in San Jose, filed their Complaint in this action on September 29, 1979 in Santa Clara County Superior Court, alleging that Sections 5703.28(c)(7) and 5703.29 of the Subject Ordinance violate the Fifth and Fourteenth Amendments of the United States Constitution because they obligate private individuals to assume the public burden of subsidizing low income tenants without just compensation.[5] On February 26, 1980, the Superior Court entered a judgment on the pleadings in favor of Appellants, declaring Sections 5703.28(c)(7) and 5703.29 unconstitutional and enjoining their enforcement.[6] The California Court of Appeal affirmed the Superior Court judgment on April 25, 1984.[7] On July 26, 1984, the California Supreme Court

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[3] Unless otherwise specified, all references to "Sections" are to the Subject Ordinance which appears as Appendix E.

[4] Section 8 of the Housing and Community Development Act of 1974 generally provides that families whose income is less than 80% of the median family income in an area qualify for assistance. 24 C.F.R. §§ 880.201, 882.102.

[5] Appellants' Complaint also sought to invalidate fees imposed on rental units under the Subject Ordinance as violative of Section 4 of Article XIIIA of the California Constitution. The Superior Court dismissed this portion of Appellants' Complaint, which dismissal has been affirmed by the Court of Appeal and the California Supreme Court. That portion of the judgment below is not being appealed.

[6] A copy of the judgment of the Superior Court appears as Appendix C.

[7] A copy of the opinion of the Court of Appeal appears as Appendix B.

granted Appellee's petition for a hearing to review the Court of Appeal decision. On August 11, 1986, the California Supreme Court reversed the judgment and held Sections 5703.28(c)(7) and 5703.29 of the Subject Ordinance to be constitutional.

THE FEDERAL QUESTION PRESENTED IS SUBSTANTIAL

1. Introduction

The California Supreme Court has previously upheld municipal rent regulation as a valid exercise of the police power if it is reasonably calculated to eliminate excessive rents and if it provides landlords with a just and reasonable return on their property. *Birkenfeld v. City of Berkeley*, 17 Cal.3d 129 (1976). That Court has also held that landlords need only be afforded a just and reasonable rate of return on their investment in, rather than on the value of their rental properties. *Fisher v. City of Berkeley*, 37 Cal.3d 644 (1984)[8] and *Carson Mobilehome Park Owners' Association v. City of Carson*, 35 Cal.3d 184 (1983). In the four to three decision appealed herein, the California Supreme Court has taken a giant step beyond validating rent control as a curative measure to eliminate excessive rents. Its decision approves tenant hardship provisions which limit rents based solely upon an individual tenant's economic and financial hardship. These provisions are repugnant to the just compensation, due process and equal protection clauses of the Fifth and Fourteenth Amendments of the United States Constitution because they shift the burden of providing financial assistance to poor renters from the public at large to individual property owners.

The question presented in this appeal involves much more than the operation of San Jose's rent control program. The decision of the California Supreme Court has a substantial impact on all municipal rent regulations. If it is constitutionally permissable to limit rents based upon an individual tenant's financial hardship, then evidence of individual tenants' financial condition should be admissable evidence at, and will greatly expand, hearings and arbitration proceedings conducted under ordinances that require or even permit consideration of any or all "relevant" factors bearing on the reasonableness of rent.

Moreover, if the reasonableness of the price for housing services under municipal rent regulations can be based, even in part, on the financial needs of the user of such services, it follows that the price for any essential goods or services can be based on the financial needs of individual consumers under any form of price control legislation. The rationale of the decision appealed herein is not limited to rent control or even price control generally, because it is predicated on the implicit assumption that cities can use their police power to exact resources from private citizens to finance purely governmental functions without regard to the benefits and burdens involved in the regulated activity.

2. The Tenant Hardship Provisions of the Subject Ordinance Violate the Just Compensation Clause of the Fifth Amendment Because They Force Property Owners to Finance the Uniquely Public Function of Providing Welfare for the Needy.

The just compensation clause of the Fifth Amendment providing that private property shall not be taken for public use, without just compensation, applies to states and their political subdivisions through the Fourteenth Amendment. *Chicago, B. & Q. R. Co. v. Chicago*, 166 U.S. 226, 239 (1897). The Supreme Court held in *Armstrong v. United States*, 364 U.S. 40 (1960) that:

> "The Fifth Amendment's guarantee that private property shall not be taken for a public use without just compensation was designed to bar government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole. . . ." *Id.*, at 49.

The Supreme Court has not developed any set formula for determining when justice and fairness require that economic injuries caused by public actions be compensated by the government rather than disproportionately concentrated on a few persons, and the Court has frequently observed that whether a particular restriction will be rendered invalid by the government's failure to pay compensation depends largely upon the particular circumstances of each case. *Penn Central Transportation Company v. City of New York*, 438 U.S. 104, 124 (1978). The court stated in that case that, "government actions that may be characterized as acquisitions of resources to permit or facilitate uniquely public functions have often been held to constitute 'takings,' " (438 U.S. at 128), citing *U.S. v. Causby*, 283 U.S. 256 (1946), which involved the government use of air space. The Supreme Court has also characterized government actions facilitating public functions as "takings" in *Armstrong v. United States, supra*, involving construction of naval vessels, *Norwood v. Baker*, 172 U.S. 269 (1898), involving construction of public roadways, and *Monongahela Navigation Co. v. United States*, 148 U.S. 312 (1893), involving construction and maintenance of public waterways.

---

[8] Probable jurisdiction was noted by this Court May 28, 1985 at 105 S.Ct. 2653 on the questions raised therein under the Sherman Act, but the appeal was dismissed with respect to the return on investment issue. The decision was ultimately affirmed on the antitrust issues in *Fisher v. City of Berkeley*, 106 S.Ct. 1045 (1986).

To develop a workable concept to determine when a "taking" occurs under the just compensation clause, it has been suggested that:

> "... when economic loss is incurred as a result of government enhancement of its resource position in its enterprise capacity, then compensation is constitutionally required; it is that result which is to be characterized as a taking. But losses, however severe, incurred as a consequence of government acting merely in its arbitral capacity are to be viewed as a non-compensable exercise of the police power." Sax, *Takings and the Police Power*, 74 Yale L.J. 36 at 63 (1964).

The only effect that Sections 5703.28(c)(7) and 5703.29 of the Subject Ordinance can have is to reduce rents determined to be reasonable under the cost and value-based factors set forth in subdivisions 1 through 6 of section 5703.28(c). Reduction of rents pursuant to Sections 5703.28(c) and 5703.29 deprive property owners of income that otherwise would have been received from the rental units involved. The right to receive income is a property right that can be the subject of an improper taking under the just compensation clause of the Fifth Amendment. *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980).

As noted by the majority opinion of the California Supreme Court, the tenant hardship provisions of the Subject Ordinance are unique and have not been considered previously by the courts. 42 Cal.3d at 371. Nevertheless, alleviation of the financial and economic hardship of San Jose's poor renters is as much a public function and government enterprise as the flight of military aircraft, building of public roads, construction of naval vessels, and maintenance of public waterways. Provisions similar to the tenant hardship provisions in the Subject Ordinance have been considered twice by the New Jersey Supreme Court which found that the burden of providing special treatment for senior citizens rests with the entire community and cannot be placed on individual landlords or other tenants in buildings occupied by senior citizens. *Prop. Owners Ass'n. etc. v. Tp. of No. Bergen*, 74 N.J. 327, 378 A.2d 25 (1977) and *Helmsley v. Borough of Fort Lee*, 78 N.J. 200, 394 A.2d 65, 84 (1978). In a case involving application of regulations to the harvesting of wild rice, the Minnesota Supreme Court has held that a taking occurs where land use regulations are designed to benefit a specific public or governmental enterprise. The public enterprise involved was the economic subsidy of Indians who traditionally harvested wild rice by hand. *Pratt v. State of Minnesota, Dept. of Natural Resources*, 309 N.W.2d 767 (1981).

The tenant hardship provisions of the Subject Ordinance are distinguishable from the kind of zoning and land use regulations that the Court has held valid without compensation, in spite of substantial diminutions in value of the property subject to the regulations. In zoning and land use cases such as *Agins v. City of Tiburon*, 447 U.S. 255 (1980), *Penn Central Transportation Company v. City of New York, supra*, and *Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1926), the governments were not acting in an enterprise capacity but were acting in their arbitral capacity, balancing competing economic interests for the promotion of the common good. To the extent that the Subject Ordinance operates to prevent unreasonable and excessive rental increases, San Jose is also acting in an arbitral capacity balancing competing interests of property owners and tenants to guard against potential rent exploitation arising out of a housing shortage. However, by enacting and enforcing the tenant hardship provisions, San Jose is acting in the enterprise capacity of supporting poor renters. By placing the burden of financing this enterprise on individual landlords, it has violated the just compensation clause.

3. The Tenant Hardship Provisions of the Subject Ordinance Violate Due Process Because They Are Not Reasonably Calculated to Eliminate Excessive Rents and Because They Serve a Policy of Shifting the Burden of Subsidizing Needy Tenants from the Public at Large to Individual Landlords Which Is Not a Policy the Legislature Is Free to Adopt.

The California Supreme Court stated in *Birkenfeld v. City of Berkeley, supra*, 17 Cal.3d at 165 that:

> "The provisions [of the rent regulations under review] are within the police power if they are reasonably calculated to eliminate excessive rents and at the same time provide landlords with a just and reasonable return on their property."

The first purpose recited for the Subject Ordinance is the prevention of excessive and unreasonable rent increases. Section 5701.2. The first five factors that must be considered in the arbitration of the reasonableness of rental increases under Section 5703.28(c) relate to the operating costs, expenses, rental history, physical condition and to other matters pertaining to the rental property involved, and the sixth factor is the value of comparable rents. All of these are clearly related to the reasonableness of rents charged. The seventh factor, however, the tenant hardship provision, requires hearing officers to consider and weigh the economic and financial hardship to the present tenant or tenants. Denial of any portion of a rental increase based upon a tenant's individual economic and financial hardship necesarily lowers the rent more than required to meet the Subject Ordinance's stated purpose of

preventing unreasonable and excessive increases.[9] Accordingly, the tenant hardship provisions of the Subject Ordinance fail to meet the test of legislative rationality quoted above from the *Birkenfeld* case.

> Price control is "unconstitutional . . . if arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt . . ."

In Re Permian Basin Area Rate Cases, 390 U.S. 747, 769-770 (1968) citing *Nebbia v. People of State of New York*, 291 U.S. 502, 539 (1934); *Birkenfeld v. City of Berkeley, supra*, 17 Cal.3d at 165. Although the tenant hardship provisions of the Subject Ordinance are demonstrably irrelevant to its policy of preventing unreasonable or excessive rental increases, such provisions are directly related its policy of alleviating the financial and economic hardship on individual tenants. The crucial due process issue of this case is, therefore, whether San Jose is free to adopt a policy requiring landlords to reduce rents that are not unreasonable or excessive for the purpose of alleviating the economic and financial hardship of individual tenants. After posing this question and observing that it is one of first impression, the majority opinion below avoids addressing it by referring to its own cases confirming the propriety of rent control ordinances that do not contain special tenant hardship provisions, citing *Birkenfeld v. City of Berkeley, supra*, *Carson Mobilehome Park Owners' Association v. City of Carson, supra*, and *Fischer v. City of Berkeley, supra*, 42 Cal.3d 371-372.

The California Supreme Court saw no reason to invalidate the reliance on individual tenant economic hardship in the Subject Ordinance because the same purpose might be accomplished from general tax revenues, and distinguished as dicta the language of *Prop. Owners Ass'n. etc. v. Tp. of No. Bergen, supra,* and *Helmsley v. Borough of Fort Lee, supra,* which state that it is not constitutional to compel landlords to subsidize special treatment for senior citizens.[10] 42 Cal.3d 365, 372-373. In its footnote 9, that Court also noted that subsequent New Jersey decisions have "concluded *Bergen* allows mandated subsidization by a property owner . . . 'as long as it is not excessive.' " 42 Cal.3d 365, 373. The Court then concluded its analysis by indicating that it might be inclined to hold the tenant hardship scheme unconstitutional if it created a disparity that could be characterized "as arbitrary or grossly unfair," but that such a review must await a challenge to the ordinance *as applied* to a particular landlord and a particular tenant.[11] 42 Cal.3d 365, 374.

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[9] The majority opinion of the California Supreme Court indicates that Appellants conceded that the tenant hardship factor bears a rational relationship to the Subject Ordinance's stated purpose of preventing unreasonable rental increases. 42 Cal.3d at 370-371. This is not correct. Appellants concede that the tenant hardship factor bears a clear relationship to the Subject Ordinance's stated purpose of alleviating undue hardship upon individual tenants, but strongly contend that the hardship factor bears no rational relationship to unreasonable rent increases.

---

[10] In *Prop. Owners Ass'n. etc. v. Tp. of No. Bergen,* supra, the New Jersey Supreme Court states:

> "We reiterate that under its police power, a municipality may in the interest of the general welfare enact ordinances to assist senior citizens provided the relationship between the purposes and the classification is rational and sound and there is not an undue taking of property of others which amounts to a constitutional confiscation. A legislative category of economically needy senior citizens is sound, proper and sustainable as a rational classification. But compelled subsidization by landlords or by tenants who happen to live in an apartment building with senior citizens is an improper and unconstitutional method of solving the problem. In view of our holding herein, we have found it unnecessary to discuss the equal protection argument adverted to us by the Appellate Division." 378 A.2d at 31.

[11] Waiting for a review of the Subject Ordinance's tenant hardship provisions as applied to a particular landlord and a particular tenant guarantees that *no judicial review will take place,* because the cost of bringing such a case, just to the Superior Court, is vastly disproportionate to the amount of lost rental income involved. The Supreme Court has held in utility rate cases that whether a regulation of prices is reasonable or confiscatory depends on the result reached, not the method used to reach that result. *Power Comm. v. Hope Gas Co.,* 320 U.S. 591, 602 (1944). However, utility rate cases involving huge sums of money and prosecuted by large utility companies are not analogous to

Implicit in the majority opinion is the assumption that special assistance legislation for the needy can be piggybacked onto price control legislation as long as the mandated subsidization is not "excessive" or "grossly unfair". If property owners can be compelled to provide financial assistance to poor renters regardless of the reasonableness of their rents, providers of any goods or services can also be required to provide such assistance without regard to the reasonableness of the prices of their goods or services.

As noted by the dissent of Justice Mosk, the majority opinion begs the due process question by treating rental increases over the "generous" 8% per annum automatically allowed as a bonus. 42 Cal.3d 376. The first six standards of section 5703.28(c) assure that such additional increases are reasonable and denial of additional increases subsidizes tenants based solely on economic hardship. Requiring subsidization of individual tenants by reduction of rents below reasonable levels is not a policy the legislature is free to adopt and is a misuse of the police power to finance the public burden of assisting the poor.

4. The Tenant Hardship Provisions of the Subject Ordinance Violate the Equal Protection Clause Because They Arbitrarily Select Property Owners for a Species of Taxation to Subsidize the Economic and Financial Welfare of Poor Tenants.

The burden of alleviating the financial and economic hardship of poor tenants must be borne by the public at large not by individual landlords. "To charge the cost of operation of state functions conducted for the public benefit to one class of society is arbitrary and violates the basic constitutional guarantee of equal protection of law." *In Re Gerald C., supra,* 36 Cal.3d 1, 6 (1984). See also, *Norwood v. Baker,* 172 U.S. 269, 279 (1898); *Dept. of Mental Hygiene v. Kirchner,* 60 Cal.2d 716 (1964);[12] *Dept. of*

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review of small amounts involved in an individual landlord tenant disputes.

[12] The Supreme court granted certiorari to review this case but, concerned that it lacked jurisdiction, remanded the case to the California Supreme Court for determination of whether that Court had decided

Mental Hygiene v. Hawley, 59 Cal.2d 247 (1963). In *Dept. of Mental Hygiene v. Kirchner, supra*, the California Supreme Court reasoned that the maintenance of the mentally ill was the responsibility of the state and characterized a charge imposed upon relatives for the care of the mentally ill committed to state institutions as a species of taxation holding:

> "A statute obviously violates the equal protection clause if it selects one particular class of persons for a species of taxation and no rational basis supports such classification." 60 Cal.2d 722.

In the above-cited cases, the California Supreme Court held, that the parent-child relationship was an insufficient basis upon which to impose the burden of the cost of such care. Providing assistance to the poor is just as much a public obligation and function as the incarceration and care of the mentally ill. The landlord-tenant relationship is a far less rational basis for imposition of the burden to finance state functions than the parent-child relationship.

The California Supreme Court distinguished *Kirchner, Hawley* and *In Re Gerald C.*, from this case because it had not applied the analysis of these three cases outside the context of responsible relative reimbursement, and reasoned that it had previously confirmed the propriety of local rent control legislation and of placing the burden of subsidizing tenants on landlords to the extent of the difference between nonregulated market rents and regulated "fair return" rents. 42 Cal.3d at 372. This reasoning ignores the difference between the purpose of the rent control legislation previously confirmed (to protect against excessive rents), and the purpose of the tenant hardship provisions of the Subject Ordinance (to reduce rents below a reasonable level in order to alleviate the economic and financial hardship of individual tenants). The imposition of the burden to support the poor

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it under the State or Federal Constitution. 380 U.S. 194 (1965). On remand the California Supreme Court affirmed that its decision was based on an independent ground under the state law. 62 Cal.2d 586 (1965).

based upon a landlord-tenant relationship is arbitrary, irrational and violates the equal protection clause.

CONCLUSION

Government enterprise should be financed through the exercise of the taxing power that spreads its cost among all citizens similarly situated, or by charges upon those who directly benefit from or burden such enterprise. Use of the police power to supplant taxation to finance public enterprise is repugnant to the concept of fairness and reasonableness inherent in the just compensation, due process and equal protection clauses. Providing welfare for the needy is a governmental enterprise, the cost of which should be spread through general taxation. It is manifestly unfair and unjust to concentrate the welfare burden on property owners charging reasonable rents for the housing services they provide. By piggybacking tenant hardship provisions onto municipal regulation otherwise directed to prevent excessive and unreasonable rental increases, the City of San Jose has misused its police power.

Dated November 6, 1986

MILLER, STARR & REGALIA

By: BURCH FITZPATRICK

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Appendix A

In the Supreme Court of the State of California

S.F. 24767

A011914

(Super. Ct. No. 435458)

Richard Pennell et al.,
Plaintiffs and Appellants,

vs.

City of San Jose,
Defendant and Appellant.

[Filed Aug. 11, 1986]

Defendant city appeals, and plaintiffs landlord and association cross-appeal, from a judgment of the Santa Clara Superior Court (i) declaring part of defendant's rent control ordinance facially unconstitutional and (ii) upholding the constitutionality of the ordinance's rental unit fee provision. We affirm the latter ruling and reverse the former.

1. The City's Appeal

In July 1979 the city enacted a rent control ordinance "to alleviate some of the more immediate needs created by San Jose's housing situation. These needs include but are not limited to the prevention of excessive and unreasonable rent increases, the alleviation of undue hardship upon individual tenants, and the assurance to landlords of a fair and reasonable return on the value of their property."

The ordinance allows a landlord to raise his rents according to the *highest* of any four methods of computation during a 12-month period: (i) he is automatically entitled to increase his rent

SEE DISSENTING OPINION

by 8 percent;[1] if he deems this insufficient, he is entitled to a larger increase based on (ii) a 5 percent increase plus specified pass-through costs[2] or (iii) certain of his increased costs of debt

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[1] Section 5703.2 of the ordinance provides: "Increases Subject to Review. Except as hereinafter provided, any rent increase or combination of increases occurring after March 31, 1979, and prior to the effective date of this Ordinance, and any increase after the effective date of this Ordinance, which taken together with any increase which took effect in the twelve (12) month period immediately preceding such increase, exceeds an aggregate of eight percent (8%) shall be subject to review under the Hearing Process."

[2] Section 5703.28 provides: "Standards of Reasonableness to be Applied to Rent Increases. Hearing Officers shall determine whether rent increases are reasonable under the circumstances taking into consideration that the purpose of this Ordinance is to permit landlords a fair and reasonable return on the value of their property while protecting tenants from arbitrary, capricious or unreasonable rent increases, and under certain circumstances, unjustified economic hardship. The Hearing Officer's determination shall be made with reference to the following standards:

> "(a) Increases Deemed Reasonable. Where the amount of the proposed rental increase consists only of passing through one or more of the following: (i) costs of capital improvements, (ii) increased costs of maintenance and operation, or (iii) costs of rehabilitation; plus no more than five percent (5%) of the monthly rent, they shall be deemed reasonable and the Hearing Officer shall allow the entire rental increase provided that:
>
> "(1) cost figures have been established to his reasonable satisfaction;
>
> "(2) the costs of capital improvements if any are averaged on a per unit basis and are amortized over a period not less than sixty (60) months;
>
> "(3) the costs of rehabilitation if any are averaged on a per unit basis and are amortized over a period not less than thirty-six (36) months;
>
> "(4) each of the costs proposed to be passed through to tenants, whether it be costs of capital improvements, increased costs of operation and maintenance, or costs of rehabilitation, bears a reasonable relationship to the purposes for which such costs were incurred and the value of the real property to which they are applied."

service.[3] If he deems even these formula increases insufficient, he is entitled to (iv) a hearing to determine the amount of rent increase that is "reasonable under the circumstances."[4] In reach-

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[3] Subdivision (b) of section 5703.28 provides: "When Costs of Debt Service Deemed to be Reasonable. Increased costs of debt service shall be deemed reasonable and allowed by the Hearing Officer where the aggregate amount of debt from whence they arise constitutes no more than seventy percent (70%) of the value of the property as established by a lender's appraisal, and no more than eighty percent (80%) of the cost of such debt service is being passed through to the tenants. Where no lender's appraisal is available, the Hearing Officer may secure such appraisal to be paid for by the landlord as a cost of maintenance and operation."

[4] Subdivision (c) of section 5703.28 provides: "Standards Applicable to Rent Increases Which Exceed the Foregoing. When the amount of any rent increase or portion thereof exceeds any of the foregoing standards under subsections (a) or (b) of this Section, the Hearing Officer shall determine what is reasonable under the circumstances taking into account any of the following factors on which he has received information:

> "(1) In the case of increased costs of debt service due to a sale or refinancing of the rental units or the building or property of which the units are a part within twelve (12) months of the increase: (i) the arms length nature of the transaction, (ii) the landlord's rate of return on the investment, (iii) the frequency of past resale or refinances, and (iv) the extent to which prior rental increases have made provisions for appreciation of asset value;
>
> "(2) the rental history of the unit or the complex of which it is a part, including: (i) the presence or absence of past increases; (ii) the frequency of past rent increases; (iii) the landlord's response to Proposition 13 savings, and (iv) the occupancy rate of the complex in comparison to comparable units in the same general area;
>
> "(3) the physical condition of the rental unit or complex of which it is a part, including the quantity and quality of maintenance and repairs performed during the last twelve (12) months;
>
> "(4) any increases or reduction of housing services since the last rental increase before the effective date of this Ordinance;
>
> "(5) other financial information which the landlord is willing to provide;
>
> "(6) existing market value of rents for units similarly situated;

ing this latter decision, the rent control hearing officer is directed to consider and balance "any of [seven] factors on which he has received information." The ordinance thereafter lists five factors related to information to be provided by the landlord ((1) his financing costs, his (2) rental, (3) maintenance and (4) service history, and (5) "other financial information which the landlord is willing to provide"), one factor related to the housing market ((6) "existing market value of rents for [comparable] units") and one factor related to tenants: "(7) *the hardship to a tenant* . . . ." (See *ante*, fn. 4, emphasis added.)

Although the ordinance provides that under this fourth method for setting a rent increase the tenant hardship factor is to be "balanced" along with six other factors, it is given potentially overriding weight in a related section of the ordinance, under which the hearing officer is (i) *directed* to consider the economic or financial effect of the proposed increase on the affected tenants, and is (ii) *permitted* to disallow all or part of an increase over that allowed by the first three methods of computing a rental increase if that part of the increase would impose an unreasonably severe financial or economic hardship on a particular tenant. (*Ante*, fn. 4.) At the same time, the ordinance provides that in all cases hearing officers must allow landlords a rent increase that yields a fair and reasonable return.[5] Whereas the ordinance requires generally that tenants prove their economic hardship, it also provides that tenants who meet certain federal standards shall be deemed to suffer from financial hardship that "*must* be weighed in the Hearing Officer's determination." (*Ibid.*) The number of such tenants falling within the latter category is potentially high: Plaintiffs assert (and defendants do not contend otherwise) that the federal standards are met by all families whose incomes are less than 80 percent of the median family income in the area.

Plaintiffs claim the ordinance is facially unconstitutional to the extent section 5703.28, subdivision (c)(6), and section 5703.29 permit a hearing officer to "disallow" a rent increase that would otherwise be supported by the initial six factors of the fourth method for calculating a reasonable rent increase. (*Ante*, fn. 4.) They appear to have abandoned the argument suggested in their opening brief (and still implicit to some extent in their present claims) that the hardship provision renders the ordinance incapable of nonconfiscatory application.[6] They also concede that the

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"(7) the hardship to a tenant as provided in Section 5703.29."

Section 5703.29 provides: "Hardship to Tenants. In the case of a rent increase or any portion thereof which exceeds the standard set in Section 5703.28(a) or (b), then with respect to such excess and whether or not to allow same to be part of the increase allowed under this Chapter, the Hearing Officer shall consider the economic and financial hardship imposed on the present tenant or tenants of the unit or units to which such increases apply. If, on balance, the Hearing Officer determines that the proposed increase constitutes an unreasonably severe financial or economic hardship on a particular tenant, he may order that the excess of the increase which is subject to consideration under subparagraph (c) of Section 5703.28, or any portion thereof be disallowed. Any tenant whose household income and monthly housing expense meets the criteria established by the Housing Assistance Payments Program under Section 8, existing housing provisions of the Housing and Community Development Act of 1974 (P.L. 93-383) and the regulations pertaining thereto, shall be deemed to be suffering under financial and economic hardship which must be weighed in the Hearing Officer's determination. The burden of proof in establishing any other economic hardship shall be on the tenant."

[5] Section 5703.28 states: "Hearing officers shall determine whether rent increases are reasonable under the circumstances taking into consideration that the purpose of this Ordinance is to permit landlords a fair and reasonable return on the value of their property while protecting tenants from arbitrary, capricious, or unreasonable rent increases, and under certain circumstances, unjustified economic hardship. . . . " (See *post*, fn. 6.)

Contrary to suggestions in the dissent, we do not read the ordinance as establishing two different fair return standards—one for those with and one for those without hardship tenants. Instead, as emphasized above, the ordinance grants all landlords the same constitutional fair return, and simply grants to those whose tenants can afford it an additional increase above that constitutionally required.

[6] To the extent this claim is still made, we reject it. "As we made clear in *Birkenfeld* [*v. City of Berkeley* (1976) 17 Cal.3d 129], whether rental regulations are fair or confiscatory depends ultimately on the result reached. (17 Cal.3d 129, 165.) That determination, of course, can only

tenant hardship factor bears a rational relationship[7] to the ordinance's stated purpose of preventing excessive and unreasonable rent increases. Instead, plaintiffs argue that for the ordinance's

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be made by analyzing a challenge to the regulation as applied. Nevertheless, we will declare a regulation invalid on its face 'when its terms will not permit those who administer it to avoid confiscatory results in its application to the complaining parties.' (*Id.*, at p. 165; see also *Cotati Alliance for Better Housing v. City of Cotati* (1983) 148 Cal.App.3d 280, 287, 291 [195 Cal.Rptr. 825]; *Hutton Park Gardens v. Town Council* (1975) 68 N.J. 543 [350 A.2d 1, 14-16].)" (Fisher v. City of Berkeley (1984) 37 Cal.3d 644, 679, affirmed (addressing antitrust issues only) (1986) ___ U.S. ___ [54 U.S.L.Week 4222, 4223].)

Plaintiffs cannot show the terms or the ordinance preclude those who administer it from avoiding confiscatory results. On the face of the ordinance it is clear that the "tenant hardship" factor may be considered as merely one of seven factors when a landlord seeks a rental increase over that to which he is entitled under the first three formulas for determining rental increases. The tenant hardship factor thus comes into play, if at all, only in determining what best accomplishes the dual purposes of the ordinance: (i) protecting tenants from excessive and unreasonable rent increases while (ii) assuring landlords a fair and reasonable return. Nothing in the ordinance suggests or requires that, when operating under this fourth rental increase provision, proof of tenant hardship requires disallowance of any or all of a contemplated rental increase. The hearing officer is required merely to "consider" and "balance" the tenant hardship evidence; nothing in the ordinance precludes him from granting an increase necessary to assure the landlord a fair return and thus avoid confiscatory results *despite* any resulting hardship. (See Butterworth v. Boyd (1938) 12 Cal.2d 140, 149.)

[7] Even though the classification is, concededly, rationally related to the goal of the ordinance, we note that the mere existence of the hardship factor might in practice tend to frustrate rather than further the goal of the ordinance: Landlords concerned with securing optimal rent increases may be reluctant to rent to those who would be able to trigger consideration of the hardship provision, or to purchase housing that would likely be rented to low income persons, thus making affordable housing for such persons even more scarce. This, however, does not make the classification constitutionally infirm, but merely illustrates the oft-noted principle that under the rational basis test we inquire only whether the classification is in any way rational, not whether it is wise.

tenant hardship provision to have any meaning, it must operate to deprive those landlords with hardship tenants of an otherwise reasonable rental increase. In essence, plaintiffs claim that although the purpose to be advanced by the hardship provisions (providing financial assistance to poor tenants) is a proper one, that burden cannot constitutionally be placed on individual landlords who happen to have hardship tenants.

As the parties observe, no California case has addressed the specific issue posed here; indeed, we are aware of no other rent control ordinance that contains a tenant financial hardship provision, let alone one that operates like this one.[8] Plaintiffs claim the ordinance is unconstitutional for at least two reasons.

They first assert the ordinance arbitrarily selects those landlords with hardship tenants to bear a burden that should be borne by all of society in contravention of Dept. of Mental Hygiene v. Kirchner (1964) 60 Cal.2d 716, 721. In *Kirchner* we held that equal protection principles prohibited the state from requiring a small class of persons—parents of adults who were involuntarily confined in state mental institutions—to pay the public expense of a patient's confinement. Relying on Department of Mental Hygiene v. Hawley (1963) 59 Cal.2d 247, in which we had recently reached a similar conclusion on either due process or equal protection grounds, we held "[t]he enactment and administration of laws providing for sequestration and treatment of persons in appropriate state institutions—subject of course, to the constitutional guaranties—who would endanger themselves or others if at large is a proper state function; being so, it follows that the expense of providing, operating and maintaining such institutions should . . . be borne by the state" (*id.*, at pp. 719-720), and that recovery could not constitutionally be had against the father of the committed patient. "This holding [in *Hawley*] is dispositive of the issue before us. Whether the commitment is incidental to an alleged violation of a penal statute, as in *Hawley*, or is essentially a civil commitment as in the instant case, the purposes of confinement and treatment or care in either case encompass the protection of society from the confined person, and his own protection and possible reclamation as a productive member of the body politic. Hence the cost of maintaining the state institution, including provision of adequate care for its inmates, cannot be arbitrarily charged to one class in the society; such assessment violates the equal protection clause." (*Id.*, at p. 720.) We recognized that a statute requiring such payment was in effect a form of taxation, and that "[a] statute obviously violates the equal protection clause if it selects one particular class of persons for a species of taxation and no rational basis supports such classification. [Citations.] Such a concept for the state's taking of a free man's property manifestly denies him equal protection of the law." (*Id.*, at pp. 722-723.)

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[8] Defendant suggests we "indirectly" approved a similar hardship provision in Nash v. City of Santa Monica (1984) 37 Cal.3d 97, 101, footnote 3. As defendant concedes, however, the issue was not in any way discussed in that case.

Although *Kirchner's* principles have been applied in various "responsible relative" reimbursement cases (see, e.g., In re Jerald C. (1984) 36 Cal.3d 1, 10 (plur. opn.) (and cases there cited)), we have not applied "*Kirchner* analysis" outside that context. In this regard, there is no authority suggesting *Kirchner* prohibits rent control generally, or that it prohibits the present tenant hardship scheme specifically. We have often confirmed the propriety of local rent control legislation that in effect placed the burden of "subsidizing" tenants (to the extent of the difference between unregulated market rents and regulated "fair return" rents) not on the local government but on local landlords. (E.g., Birkenfeld v. City of Berkeley (1976) 17 Cal.3d 129; Carson Mobilehome Park Owners' Assn. v. City of Carson (1983) 35 Cal.3d 184; *Fisher*, supra, 37 Cal.3d 644.) As the United States Supreme Court recently held, "the function of government may often be to tamper with free markets, correcting their failures and aiding their victims," and rent control is an example of one such function. (Fisher v. City of Berkeley, supra, ____ U.S. ____, ____ [54 U.S.L.Week 4222, 4223].)

The possibility that local governments could accomplish the same result through a subsidy from general tax revenues has never been considered a bar to the validity of such legislation (on equal protection or any other ground) and we see no reason why

such a possibility should operate to invalidate the limited reliance on economic hardship that is part of the ordinance under consideration here.[9] Indeed, this ordinance appears more finely tailored

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[9] For similar reasons we reject plaintiff's claim that a New Jersey case, Prop. Owners Ass'n, Etc. v. TP. of No. Bergen (1977) 378 A.2d 25, compels a ruling in their favor. *Bergen* involved a city rent control ordinance that provided a 15 percent annual rent increase for all units except those occupied by certain low income senior citizens. For such senior tenants the ordinance authorized no rent increase, but instead allowed the landlord to apply to the city for a subsidy, to be paid from public funds, to cover 10 percent over a qualified senior's frozen rent. The *Bergen* majority held the ordinance unconstitutional not because it allegedly placed on private persons a public burden, and not because it allegedly violated equal protection, but because it lacked a provision permitting a landlord to secure a subsidy over 10 percent if such an amount was necessary to avoid confiscatory results. (378 A.2d at pp. 27, 29-30.) It followed, the court reasoned, that "[u]nder the terms of the ordinance, [a] landlord may not recoup any additional funds to which he is rightfully entitled. Imposition of that burden would deprive an owner of property without due compensation. Such rent control is confiscatory and unconstitutional." (*Ibid.*) Although the *Bergen* opinion contains dicta suggesting the ordinance there improperly placed on private persons an exclusively public burden (*Id.*, at pp. 27-28), and that it also suffered from various equal protection problems (*Id.*, at p. 30; but see Pashman, J., dis. at pp. 32-34), the opinion clearly does not rely on the former and expressly declines to rely on the latter, and hence does not stand for the proposition asserted by plaintiffs.

The New Jersey Supreme Court has applied *Bergen* to invalidate—on due process "confiscatory" grounds—a rent control ordinance limiting rent increases for senior tenants to 80 percent of the formulate rate. (Helmsley v. Borough of Fort Lee (1978) 394 A.2d 65, 84.) The appellate division of the superior court, applying *Bergen*, has upheld a building permit condition requiring a developer to provide 10 percent of his 1,530 housing units to low income persons, and another 10 percent to moderate income persons. (In re Egg Harbor Associates (N.J. Super A.D. 1982) 449 A.2d 1324, 1333-1334, affd. *sub nom.* Matter of Egg Harbor Assoc. (Bayshore Centre) (N.J. 1983) 464 A.2d 1115.) The *Egg Harbor* court found the requirement "rationally related to the benefits and burdens created by the project itself" (449 A.2d at p. 1333), and concluded *Bergen* allows for "mandated subsidization by a property owner . . . 'as long as it is not excessive.' " (*Id.*, at p. 1334, to local needs than "across-the-board" rent control: while granting a generous 8 percent automatic increase to all landlords, it offers the potential for even more liberal increases to those whose tenants can bear the additional increase without financial hardship. At the same time, and consistent with the ordinance's stated purpose, it provides that the additional rent increase may be denied if doing otherwise would pose a financial hardship to a particular tenant.

Plaintiffs next suggest the ordinance violates equal protection by its disparate treatment of those landlords with, and those without, hardship tenants. But as noted in Cotati Alliance for Better Housing v. City of Cotati (1983) 148 Cal.App.3d 280, equal protection is not denied simply because some landlords may receive rents different (albeit nonconfiscatory) from those received by other landlords with similarly situated apartments *as long as there exists a rational basis for the distinction.* (*Id.*, at p. 291.)

Plaintiffs suggest nothing to convince us that the city's selection of those landlords with hardship tenants (as opposed to all landlords) to bear the burden of "subsidizing" hardship tenants is without any rational basis. Certainly a city could constitutionally elect to regulate only the rents charged for low- and medium-priced apartments and could decline to regulate, or choose to regulate only minimally, the rents of high-priced units. The purpose of a so-structured regulatory scheme would be to assist only those who need assistance; the assumption underlying such a scheme would be that financially needy tenants reside in low- and medium-priced units and not in high-priced units. The present ordinance addresses the same purpose in a more precise fashion by differentiating between hardship and nonhardship tenants, through the rational means of distinguishing between their respective landlords. As noted in *Cotati Alliance*, supra, "courts consistently defer to legislative determinations as to the desirability of such distinctions." (*Id.*, at pp. 291-292.) We see no reason to depart from that settled rule here.

Although we might be inclined to hold such a scheme unconstitutional if the disparity in approved rents among landlords with and without hardship tenants was shown to be so great as to be characterized as arbitrary or grossly unfair, no basis for such a conclusion appears at this stage of the litigation. Again, under this ordinance *all* landlords are *guaranteed* a generous 8 percent rental increase each year as a matter of right, *regardless* of the hardship thereby imposed on any individual tenant. We cannot know the extent to which the tenant hardship factor if triggered, might in practice reduce an affected landlord's otherwise allowable rental increase, and might consequently create a disparity that could be characterized as arbitrary or grossly unfair. Such an attack on the ordinance's tenant hardship provisions must await a challenge to the ordinance as applied to a particular landlord and a particular tenant.

2. Plaintiffs' Cross-Appeal

California Constitution, article XIIIA, section 4, enacted in June 1978 as part of Proposition 13, provides that "Cities, Counties and special districts, by a two-thirds vote of the qualified electors of such district, may impose *special taxes* on such district, except ad valorem taxes on real property or a transaction tax or sales tax on the sale of real property within such City, County or special district." (Emphasis added.) Plaintiffs claim the $3.75 per year rental unit fee imposed under the ordinance[10] is

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quoting Matter of Review of Health Care Admin. (N.J. 1980) 415 A.2d 1147, 1155.) Finally, the New Jersey Supreme Court has held that *Bergen* does not invalidate municipal ordinances requiring developers to set aside a portion of a development for low income housing. (So. Burlington Cty. N.A.A.C.P. v. Mt. Laurel TP. (1983) 456 A.2d 390, 446, fn. 30.)

[10] Section 5704.1 of the ordinance provides: "Fees. The costs of providing and administering the San Jose Rental Dispute Mediation and Arbitration Hearing Process shall be reimbursed to the General Fund by impositon of a fee chargeable against each rental unit in the City of San Jose subject to the provisions of this Chapter."

Section 5704.2 of the ordinance provides: "Amount of Fee. There is hereby imposed on each rental unit, subject to the provisions of this Chapter, a fee of three dollars and seventy-five cents ($3.75) per year which shall be paid annually at the time at which the landlord's business license fee under Article VI or Article XII of this Code is due. Said fee a "special tax" that cannot be imposed absent a two-thirds majority of the city's voters. The city, on the other hand, insists the charge is merely a regulatory fee and hence not subject to the constitutional provision. As noted (*ante*, fn. 10), the ordinance's rental unit fee is to be paid on each rental unit and is designed to defray the costs of providing and administering the hearing process prescribed in the ordinance, not to pay general revenue to the local government. The relatively minor unit fee imposed here does not "exceed the sum reasonably necessary to cover the costs of the regulatory purpose sought." (United Business Com. v. City of San Diego (1979) 91 Cal.App.3d 156, 165.) The rental unit change is clearly a regulatory fee. (See City & County of San Francisco v. Boss (1948) 83 Cal.App.2d 445, 450-451.)

We agree with Mills v. County of Trinity (1980) 108 Cal.App.3d 656, which, in a similar situation, concluded that "The 'special tax' referred to in section 4 of article XIII A does not embrace fees charged in connection with regulatory activities which fees do not exceed the reasonable cost of providing services necessary to the activity for which the fee is charged and which are not levied for unrelated revenue purposes." (*Id.*, at pp. 659-660; see also, *id.*, at pp. 662-663, discussing the Legislature's interpretation of "special taxes" in Gov. Code, § 50076; *United Business Com.*, supra, 91 Cal.App.3d at pp. 164-167; County of Plumas v. Wheeler (1906) 149 Cal. 758, 764.) Accordingly, the trial court properly upheld the ordinance's rental unit fee provision.[11]

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is includable as a cost of maintenance and operation under the definition contained in Section 5702.4. The City Manager and the Commission shall report to the Council in time for budget hearings each year their recommendation as to the amount of such fee necessary to recover the costs of the Hearing Process."

[11] Contrary to plaintiffs' view, the fact that landlords may not believe they "benefit" from the rental unit fee does not transform a regulatory fee into a "special tax." It is well settled that a municipality under the police power may impose a regulatory fee when, as here, the fee constitutes an amount necessary to carry out the purpose and provisions of the regulation. (*United Business Com.*, supra, 91 Cal.App.3d at

The judgment is reversed insofar as it declares the tenant hardship provisions facially unconstitutional. In all other respects the judgment is affirmed.

GRODIN, J.

WE CONCUR:
BIRD, C.J.
BROUSSARD, J.
REYNOSO, J.

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p. 165; accord, *Mills, supra,* 108 Cal.App.3d at pp. 659-660; 9 McQuillin, Municipal Corporations (3d ed. 1978) § 26.15, p. 29.)

Pennell et al. v. City of San Jose
S.F. 24767

DISSENTING OPINION BY MOSK, J.

I dissent.

Satisfying the housing needs of persons in lower economic strata is necessary, but the issue is whether that obligation can be thrust upon private property owners rather than remaining the responsibility of society as a whole through tax-supported government agencies. The majority have selected an alternative they concede is unprecedented—no other city ordinance has been so written and no California case has approved a comparable technique—and I am convinced this scheme is unconstitutional.

The ordinance exhibits constitutional infirmity on its face. While the ordinance allows both automatic and cost-related increases to the *landlord* (§§ 5703.2, 5703.5, 5703.28, subds. (a) & (b)), section 5703.28, subdivision (c)(6), makes the additional rent increase dependent on the *tenant's* financial hardship. (§ 5703.29.) This criterion is entirely arbitrary and unjustifiable; indeed, it runs counter to a legitimate purpose of rent control regulation, i.e., assurnace of a fair and reasonable return on the owner's investment.

As the majority themselves point out, tenant hardship is given potentially overriding weight under the ordinance. Thus, tenants qualifying under certain federal standards—a large category made up of all families in San Jose whose income is less than 80 percent of the median—are "deemed" to suffer economic hardship "which must be weighed" in the hearing officer's determination (Ibid.) Giving meaningful weight to that factor necessarily results in depriving landlords of what the hearing officer would otherwise calculate as a reasonable return, based on the particular rental history of the unit, its condition, housing services provided, financial information such as debt service, and existing market value for comparable units. (§ 5703.28, subd. (c)(1)-(5).)

The majority simply beg the question when they treat the portion of the rental determination that subdivision (c) might permit as in effect a bonus for landlords with non-hardship tenants. It is true that such rents exceed those permissible as a matter of right under the other provisions of the ordinance. (§ 5703.28, subds. (a) & (b); § 5703.2.) Nevertheless, the hearing officer is required by the clear language of the provision to determine if a rental increase is "reasonable under the circumstances," not to authorize the receipt of more rents than a landlord is due. If a proposed rent is truly in excess of his due, it will be unreasonable by definition. Indeed, the stated purpose of the section is to provide a means by which a landlord can receive a fair return on his particular unit when the increases permissible by right are deficient, inadequate and therefore "*[un]reasonable under the circumstances.*"

Simply on the basis of the hardship status of his tenant, one landlord will receive a significantly lower rent than another landlord in *identical* circumstances if the latter merely had the good fortune of renting to a nonhardship tenant. That disparity is untenable when it means that the former landlord is deprived of the reasonable return on his property to which he would otherwise be entitled. Such uneven treatment amounts to a forced subsidy imposed on the landlord in violation of the due process clauses of the United States and California Constitutions, which prohibit the taking of property without just compensation. (See Prop. Owners Ass'n, etc. v. Tp. of No. Bergen (N.J. 1977) 378 A.2d 25, 29.)

Moreover, although we have repeatedly upheld rent control ordinances that apply to landlords as a class, this measure goes a critical step further by requiring individual landlords to reduce rentals for individual tenants with financial hardship. There is no rational link, either in the benefit gained or the burden created, which would justify imposing that welfare obligation as a one-on-one subsidy, rather than spreading the imposition fairly through the class of landlords generally or taxpayers as a whole.

The majority discount the obvious analogy to our reasoning in Dept. of Mental Hygiene v. Kirchner (1964) 60 Cal.2d 716, because we have not previouly extended that case explicitly to rent control matters. I believe, on the contrary, that *Kirchner* is on all fours with the unusual circumstances of this case: a small class of persons, here landlords of hardship tenants, are required to shoulder what is essentially a public burden, in this case the social necessity of easing the plight of economically depressed citizens. Such a subsidy—like the requirement in *Kirchner* that relatives of persons committed involuntarily to mental institutions pay the costs of treatment—amounts to involuntary taxation. As we held in *Kirchner*, "A statute obviously violates the equal protection clause if it selects one particular class of persons for a species of taxation and no rational basis supports such classification." (Id. at p. 722.)

The tragic aspect of the provision is that it will likely prove detrimental to the very interests it seeks to protect. Landlords, who will have a great deal to lose by renting to economically marginal tenants, hereafter will carefully screen potential tenants to assure themselves of remaining entitled to a fair return on their properties. It is ironic that in upholding this unconstitutional ordinance the majority accede to a counterproductive result.

MOSK, J.

WE CONCUR:

LUCAS, J.
ALEX SALDAMONDO*

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* Judge of the Municipal Court, City and County of San Francisco, assigned by the Chairman of the Judicial Council.

Appendix B

Certified for Publication See Dissenting Opinion
In the Court of Appeal of the State of California
A011914
(Santa Clara Super. Ct. No. 435458)
Richard Pennell, Tri-County Apt. House
Owners Association,
Plaintiff, Respondent & Appellant
vs.
City of San Jose, City Council of
the City of San Jose,
Defendants, Appellants, Respondents
[Filed April 25, 1984]

On August 7, 1979, the City Council of San Jose adopted Ordinance No. 19696 entitled "The San Jose Rental Dispute Mediation and Arbitration Ordinance"[1] (hereinafter Rent Control Ordinance or Ordinance) which imposed certain limitations upon the rents to be paid by the tenants in the City of San Jose. A few weeks later, on September 28, 1979, plaintiffs Richard Pennell, an individual homeowner, and the Tri-County Apartment House Owners Association representing the landlords in the area affected by the Ordinance (hereafter Pennell or respondents) brought an action for declaratory and injunctive relief against defendants City of San Jose and the City Council of the City of San Jose (hereafter City or appellants). The complaint launched a two-pronged constitutional attack against the Ordinance. First, it alleged that sections 5703.28, subdivision (c)(7) and 5703.29, which allowed the consideration of the tenant's financial and economic situation in determining a just and fair rent were unconstitutional because they deprived the landlords of their property without just compensation and thereby violated their due process right under the Fifth and Fourteenth Amendments to the United States Constitution. The complaint further alleged that sections 5704.1 and 5704.2 were likewise unconstitutional because they permitted the imposition of special taxes upon each rental unit without the requisite two-third votes of the qualified electors in circumvention of section 4 of article XIIIA of the California Constitution.

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[1] Unless otherwise indicated, all regulatory references will be to the provisions of the Rent Control Ordinance.

The City challenged the complaint by demurrer filed on November 28, 1979. Subsequent to the ruling on the demurrer Pennell moved for judgment on the pleadings on February 11, 1980. After hearing the arguments of the parties the trial court ruled that sections 5703.28, subdivision (c)(7) and 5703.29 were unconstitutional because they obligated private individuals (landlords) to assume public burdens without just compensation thereby violating their rights to substantive due process. With respect to the second part of the respondents' contention the trial court declared that the annual $3.75 fee levied upon each rental unit pursuant to sections 5704.1 and 5704.2 constituted a regulatory fee rather than a special tax and that the imposition of such fees was valid without the approval of the two-third majority of the voters.

From the ruling of the trial court both parties appealed. The City filed a notice of appeal from that portion of the judgment which declared the consideration of the tenant hardship factor unconstitutional on its face. Pennell cross-appealed from the adverse determination that the imposition of rental unit fee was not prohibitive of section 4 of article XIIIA of the California Constitution.

On appeal, the parties basically reiterate their legal arguments made in the trial court. Appellants contend that the trial court erred in holding that the consideration of the tenant's economic hardship (§§ 5703.28, subd. (c)(7) and 5703.29) rendered the Ordinance facially unconstitutional and confiscatory. Respondents, in turn, complain that the trial court committed error in concluding that rental unit charges imposed under sections 5704.1 and 5704.2 were, in essence, regulatory fees not special taxes and thus not subject to the limitation set out in section 4 of article XIIIA of the California Constitution. We analyze and discuss the issues raised in the appeal and cross-appeal in separate sections.

THE APPEAL

Constitutionality of Rent Control Provisions of the Ordinance.

Before addressing appellants' contention on the merit, preliminarily we set out the legal principles governing the constitutionality of a rent control ordinance.

In *Birkenfeld v. City of Berkeley* (1976) 17 Cal.3d 129, our Supreme Court held that rent control is a proper exercise of the local government's police power if it is reasonably calculated to eliminate excessive rents and at the same time provide the landlords with a just and reasonable return on their property. However, if it is apparent from the face of the provisions of the ordinance that their effect will necessarily be to lower rents more than could reasonably be considered to be required for the measure's stated purpose, they are unconstitutionally confiscatory (*Id.*, at p. 165; see also *Cotati Alliance For Better Housing v. City of Cotati* (1983) 148 Cal.App.3d 280, 285; *City of Miami Beach v. Forte Towers, Inc.* (Fla. 1974) 305 So.2d 764, 768). While the determination of whether a rent control regulation is reasonable or confiscatory depends on the individual circumstances of each case, it has been said that where the methods used in the regulation are wholly arbitrary or based upon invalid criteria and where the application of said criteria would lead to a forced rent subsidy on the part of the landlord, the regulation is violative of due process, unconstitutional on its face and must be stricken (*FPC v. Texaco Inc.* (1974) 417 U.S. 380, 391-392; *Prop. Owners Ass'n, etc. v. Tp. of No. Bergen* (1977) ___ N.J. ___ [378 A.2d 25, 29-30; *Hutton Park Gardens v. Town Council* (1975) 68 N.J. 543 [350 A.2d 1, 13-15].

The Ordinance at bench exhibits a constitutional infirmity upon its face. While the Ordinance allows both automatic and cost-related increases (§§ 5703.2, 5703.4, 5703.5, 5703.28, subds. (a) and (b)), section 5703.28, subdivision (c)(6) makes the additional rent increase dependent on the tenant's financial hardship. (§ 5703.29[2]) Needless to say this criterion is totally arbitrary and unjustifiable inasmuch as it runs counter to a legitimate purpose of the rent control regulation (i.e., an assurance of a fair and reasonable return on the investment of the owner). Furthermore, it amounts to a forced subsidy on the part of the landlord in violation of the due process clauses of the United States and California Constitutions which prohibit taking of property without just compensation. Moreover, the tenant's financial situation as a factor in arriving at the proper amount of rent also violates the equal protection provisions of the Constitution, inasmuch as it comprises an invalid classification based upon wealth or lack thereof (*Dept. of Mental Hygiene v. Kirchner* (1964) 60 Cal.2d 716, 721).

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[2] Section 5703.29 provides that "In the case of a rent increase or any portion thereof which exceeds the standards set in Section 5703.28(a)

In reaching the above conclusion, we are greatly aided by *Prop. Owners Ass'n, etc. v. Tp. of No. Bergen, supra,* 378 A.2d 25, a case right on point. In *Bergen,* the amended ordinance allowed rental increases to the maximum of 15 percent per year for all causes, but banned any rental increase for senior citizens (i.e., persons aged 65 years or older whose income did not exceed $5,000 annually). In holding that the amended ordinance was confiscatory on its face and violative of both the due process and equal protection clauses of the Constitution, the reviewing court cited with approval the trial judge who in his reasoning set out as

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or (b), then with respect to such excess and whether or not to allow same to be part of the increase allowed under this Chapter, the Hearing Officer *shall consider the economic and financial hardship imposed on the present tenant or tenants of the unit or units to which such increases apply.* If, on balance, the Hearing Officer determines that the proposed increase constitutes an unreasonably severe financial or economic hardship on a particular tenant, he may order that the excess of the increase which is subject to consideration under subparagraph (c) of Section 5703.28, or any portion thereof, be disallowed. Any tenant whose household income and monthly housing expense meets the criteria established by the Housing Assistance Payments Program under Section 8, existing housing provisions of the Housing and Community Development Act of 1974 (P.L. 93-383) and the regulations pertaining thereto, shall be deemed to be suffering under financial and economic hardship which must be weighed in the Hearing Officer's determination. The burden of proof in establishing any other economic hardship shall be on the tenant." (Emphasis added.)

follows: "Now, more importantly, however, the Ordinance is unconstitutional as a deprivation of property without due process of law. By this Ordinance the Municipality seeks to establish a special subsidy for those who the fathers, the Legislative fathers of the Municipality think should get a break in connection with rent increases. This is a fine reason and something to be applauded. However, this can be constitutionally done only on the basis of an overall use of public funds which then is distributed among all the taxpayers by virtue of taxation. And so we have that in [m]any types of legislation which counsel has cited where the burden rests upon the entire community, in which event special treatment of people in need is fully justified and constitutional. We have it from welfare up. We have senior citizen housing. We have other types of legislation which are properly protective of the rights where need appears [f]or special categories of persons. However, in every one of these instances the burden of supporting these people partially, of granting them a subsidy, is a public burden and should be borne by the entire community. Here, however, the Municipality undertakes to attempt to shift its burden, that is the burden of all the citizens and taxpayers of the Municipality, to a particular class of individuals, namely, persons who own property, and demand that those persons take care of the needs of the community as a whole. That to my mind constitutes a clear-cut taking of property without due process. Selecting a particular class of people in the community to subsidize another class of people in the community is hardly constitutional in its approach.

"Now, in this area of discrimination I didn't mention during our colloquy one facet, namely, not only discrimination against the landlord, but I can see a potential of discrimination against other tenants in a building under the pattern of the Rent Control Ordinance of the Municipality. And it arises in this way: If a landlord is burdened with a reduction in his income by virtue of the failure and inability to increase the rents of senior tenants in his building because of this amendment and he is thereby compelled to apply for an overall hardship increase within the additional ten percent permitted in the legislation, and such increase is granted, then, in effect, the other tenants in the building who are not sixty-five and who have an income over $5,000 will ultimately be paying more rent because of the lack of contribution by these other tenants towards the overall income of the landlord. This is another form of discrimination which is a practical result of this kind of legislation by the Municipality." (*Id.*, at pp. 27-28.)

The above stated rationale applies with equal force to the Ordinance at bench. As a consequence, the ruling of the trial court that section 5703.28, subdivision (c)(7) and section 5703.29 of the Ordinance are unconstitutional must be held correct and sustained on appeal.

THE CROSS-APPEAL

Constitutionality of Rental Unit Fee

California Constitution article XIIIA section 4 (which was enacted on June 6, 1978, as a part of Proposition 13) provides that "Cities, Counties and special districts, by a two-thirds vote of the qualified electors of such district, may impose *special taxes* on such district, except ad valorem taxes on real property or a transaction tax or sales tax on the sale of real property within such City, County or special district." (Emphasis added.)

In their cross-appeal respondents argue that the rental unit fee imposed under sections 5704.1 and 5704.2[3] constitutes a special

tax within the meaning of the cited provisions of the California Constitution and that as a consequence the imposition of such fees is constitutionally invalid in the absence of the requisite two-third majority votes.

Respondents' position is unacceptable for the reason that the rental unit fee exacted on the property owners pursuant to the Ordinance constitutes a regulatory fee rather than a special tax and therefore does not fall within the quoted section of the California Constitution.

In defining "special tax" within the meaning of article XIIIA of the California Constitution, Government Code section 50076 explicitly provides that "As used in this article, "special tax" shall not include any fee which does not exceed the reasonable cost of providing the service or regulatory activity for which the fee is charged and which is not levied for general revenue purposes."

The rental unit charge imposed upon the landlords under the Ordinance clearly qualifies as a regulatory fee within the aforestated definition of the statute. As pointed out earlier, section 5704.1 provides that the charge is to be paid on each rental unit; that it is to defray the costs of providing and administering the hearing process prescribed in the Ordinance; and that such costs shall be reimbursed to the general fund. Section 5704.2 likewise emphasizes that the rental unit fees are necessary to recover the cost of the hearing process mandated by the Ordinance. In short, the cited provisions of the Ordinance demonstrate that the levy of rental unit fees is for the purpose to recover the cost of the hearing process and not to pay general revenue to the local government. Under the prevailing law, this kind of payment is distinguishable from a tax which is levied to provide general revenue for the government and has no relation to the value of services furnished by the government (*County of Fresno v. Malmstrom* (1979) 94 Cal.App.3d 974, 983-984. Here, the tax amounts clearly to a regulatory fee inasmuch as it does not " 'exceed the sum reasonably necessary to cover the costs of the regulatory purpose sought' " or "the reasonable expense of the regulatory activities" (*Mills v. County of Trinity* (1980) 108 Cal.App.3d 656, 660-661; see also *County of Plumas v. Wheeler*

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[3] Section 5704.1 provides that "*The costs of providing and administering* the San Jose Rental Dispute Mediation and Arbitration *Hearing Process shall be reimbursed to the General Fund* by imposition of a fee chargeable against each rental unit in the City of San Jose subject to the provisions of this Chapter." (Emphasis added.)

Section 5704.2, in turn, sets out that "There is hereby imposed on each rental unit, subject to the provisions of this Chapter, a fee of three dollars and seventy-five cents ($3.75) per year which shall be paid annually at the time at which the landlord's business license fee under Article VI or Article XII of this Code is due. Said fee is includable as a cost of maintenance and operation under the definition contained in Section 5702.4. The City Manager and the Commission shall report to the Council in time for budget hearings each year their recommendation *as to the amount of such fee necessary to recover the costs of the Hearing Process*." (Emphasis added.)

(1906) 149 Cal. 758, 763; *United Business Com. v. City of San Diego* (1979) 91 Cal.App.3d 156, 165).

Respondents' claim that the rental unit charges constitute special taxes because the Rent Control Ordinance confer no benefit upon the owners of the property, may be disposed of for two reasons. First, Government Code section 50076 exempts all regulatory fees from the definition of special taxes whether the regulation benefits the property or not. Second, it is well settled that a municipality under the police power may impose a fee for the purpose of regulation where, as in the instant case, the fee constitutes an amount necessary to carry out the purpose and provisions of the regulation (*United Business Com. v. City of San Diego, supra,* 91 Cal.App.3d at p. 165; accord, *Mills v. County of Trinity, supra,* 108 Cal.App.3d at pp. 659-660; *Redwood Theatres, v. City of Modesto* (1948) 86 Cal.App.2d 907, 919; 9 McQuillin, Municipal Corporations (3d ed. 1978) § 26.15, p. 29).

The judgment is affirmed.

Caldecott, P.J.

I CONCUR in the judgment.

Panelli, J.

Pennell vs. City of San Jose, et al.
A011914/1 Civil 50950

I respectfully dissent from the determination that section 5703.28, subdivision (c)(7) and section 5703.29[1] of the San Jose Rental Dispute Mediation and Arbitration Ordinance (Rent Control Ordinance) are each unconstitutional. In all other respects I concur in the majority opinion.

In order to pass any judgments with respect to the ordinance it is first necessary to understand its operation in overview:

As a matter of right the landlord of a rental unit regulated by the ordinance is entitled to increase its rent by eight percent (8%) in any twelve-month period.

If the landlord decides to increase the rent more than eight percent he has two options: (1) to invoke the hearing process by filing a petition with the San Jose Advisory Commission; or (2) to simply give the tenant written notice of the rent increase. In the latter case the landlord's full proposed increase becomes operative unless the tenant files a timely petition to have the reasonableness of the increase determined. Irrespective of the method chosen the tenant must pay the prior rental amount plus no less than the eight percent increase until a final determination is made by the hearing officer or arbitrator. The tenant must also pay whatever amount over eight percent is determined to be reasonable by the hearing officer during the pendency of any appeal to the arbitrator.

Initially, a mediation hearing officer conducts a preliminary evidentiary hearing and makes a written determination concerning whether the increase is reasonable under the standards set forth in section 5703.28. If the officer determines all or any portion of the *excess* over eight percent is not reasonable, a 30-day mediation process occurs in which the officer and a specific memorandum of agreement concerning any amount not determined to be reasonable. Absent agreement, the hearing officer grants the increase he determines complies with the standards, and each party has seven days to appeal the determination to an arbitrator. The arbitrator conducts an initial hearing, reviews the prior record and other matters provided by each party and makes a written determination with supporting findings of fact; this decision must also be based on the standards of section 5703.28, and is final for judicial review purposes. Any amount determined by the mediation hearing officer as reasonable—even in excess of eight percent—must be paid by the tenant pending resolution of the dispute before the arbitrator. (§ 5703.21.)

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[1] Unless otherwise indicated, all further references are to the Rent Control Ordinance.

The hearing officer and arbitrator are required to make the following determinations and allowances under section 5703.28, subdivision (a): as a matter of right the landlord is entitled to the entire rental increase, if it consists of five percent of the monthly rent *plus:* (1) costs of capital improvements averaged on a per unit basis and amortized over not less than 60 months; and (2) costs of rehabilitation averaged on a per unit basis amortized over not less than 36 months; *and* (3) increased costs of maintenance or operation, where the cost figures are established and bear a reasonable relationship to the purposes incurred and the property's value. Under section 5703.28, subdivision (b) the landlord is *also* entitled, as a matter of right (in addition to the eight percent or the 5% plus pass-through costs) to the prorated increased cost of debt service with certain limitations.

In *addition* to the rental increase prescribed as a matter of right for the landlord under section 5703.28, subdivisions (a) and (b), the hearing officer and arbitrator are required to "determine what is reasonable under the circumstances" taking into account information concerning each of the following seven factors: (1) increased debt service costs due to sale or refinancing the rental units or building within one year, including the landlord's rate of investment return, frequency of resale or refinance, and reflection of rental increases on appreciation of asset value; (2) prior rental history, including amount and frequency of past increases, response to Proposition 13 savings, comparable occupancy rates; (3) physical condition, quantity and quality of maintenance and repairs; (4) increase or decrease in housing services; (5) "other financial information which the landlord is willing to provide"; (6) existing market value of rents for comparable units; and

(7) *"hardship to a tenant, as provided in Section 5703.29."* (§ 5703.28, subd. (c).)

Thus the hearing officer or arbitrator is permitted to *"consider* the economic and financial hardship imposed on the present tenant" only after the landlord has been awarded an increase of five percent plus capital improvements as provided in section 5073.28, subdivisions (a) and (b). Such tenant hardship is a relevant consideration only with respect to whether and to what extent the landlord will be allowed an increase in *excess* of the five percent plus capital improvements as previously determined under section 5073.28, subdivisions (a) and (b).

All that is required of the hearing officer or arbitrator in connection with the use of evidence concerning tenant hardship is that it be *considered, weighed* and *balanced.*

It is clear from the fact of the ordinance that the section 5703.28 and section 5703.29 standards and provisions only permit the hearing officer and arbitrator to consider *tenant hardship* as one of many relevant factors in making a final determination on what excess, above the eight percent and/or amount required under section 5703.28, subdivisions (a) and (b), implements the two-fold purpose of the ordinance: to allow a fair and reasonable return to the landlord and to protect the tenant from arbitrary, capricious or unreasonable increases. No provision of the ordinance forecloses consideration of all the relevant factors in section 5703.28, subdivision (c), nor does proof of tenant hardship require a disallowance of all or any portion of the excess. Thus the majority opinion is simply inaccurate in its determination that a rental increase is made "dependent" on the tenant's financial hardship. (Majority opn., *ante,* at p. 5.)

The law is equally clear and well settled. A rent control ordinance is a proper exercise of a local government's police power if it is reasonably calculated to eliminate excessive rents and at the same time provides the landlord with a just and reasonable return on their property. (*Birkenfeld v. City of Berkeley* (1976) 17 Cal.3d 129, 165; *Cotati Alliance for Better Housing v. City of Cotati* (1983) 148 Cal.App.3d 280, 285.) While the determination of what constitutes a fair and reasonable return is a complex question involving both factual and legal aspects, the court must take into account not only the interest of investors but also the interests of consumers and the general public. (See *Cotati Alliance for Better Housing v. City of Cotati, supra,* at p. 294.)

Whether a rent control regulation is reasonable or confiscatory depends not on the formula used but on the result reached. (*Carson Mobilehome Park Owners' Assn. v. City of Carson* (1983) 35 Cal.3d 184, 191.) There are only two situations in which such a regulation may be held facially unconstitutional. The first involves the situation where the regulation is so restrictive as to preclude any possibility of a fair and reasonable return. (*Cotati Alliance for Better Housing v. City of Cotati, supra,* 148 Cal.App.3d at p. 291.) The second involves an ordinance whose terms will not permit those who administer it to avoid confiscatory results in its application to the complaining party. (*Carson Mobilehome Park Owners' Assn. v. City of Carson, supra,* 35 Cal.3d at pp. 191-192; *Birkenfeld v. City of Berkeley, supra,* 17 Cal.3d at p. 165; *Cotati Alliance for Better Housing v. City of Cotati, supra,* Cal.App.3d at p. 294, and fn. 14.) Neither situation exists here nor does the majority opinion indicate that it does.

Instead, tenant hardship is simply one of many factors to be considered in assuring a fair and reasonable return for landlords. Nothing in the Rent Control Ordinance precludes the hearing officer or arbitrator from granting an increase necessary to assure a fair and reasonable return in spite of resulting tenant hardship. Thus the ordinance does not on its face deny due process.

This court also finds that the same provisions—on their face—violate equal protection. The best answer is contained in the recent case of *Cotati Alliance for Better Housing v. City of Cotati, supra,* 148 Cal.App.3d 280: "... Equal protection is not denied simply because an ordinance treats one class of persons differently from another. Where there is no suspect classification, and purely economic interests are involved, a municipality may impose any distinction which bears some 'rational relationship' to a legitimate public purpose. [Citation.] Courts consistently defer to legislative determinations as to the desirability of such distinctions. [Citation.] The ordinance will be upheld so long as the

issue is ' "at least debatable." ' [Citation.] [¶] It is 'at least debatable' in the present case that the return on investment standard bears a rational relationship to a legitimate public purpose. The investment-based standard, unlike a value-based standard, ensures that inflationary factors will not be built into a rent control ordinance's rent ceiling adjustment mechanism, and thereby ensures the integrity of the entire rent control scheme. This court must defer to the local governmental determination as to the desirability of any consequential disparate treatment of landlords." (*Id.,* at pp. 291-292.)

Because we do not sit as a legislature or as a critic of the wisdom of legislative language I would affirm the judgment except that portion which finds section 5703.28, subdivision (c)(7) and section 5703.20 of the ordinance unconstitutional. Strict construction of the Constitution requires no less.

Poche, J.

Appendix C

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Attorneys for Plaintiffs

Superior Court of California,
County of Santa Clara

No. 435358

Richard Pennell, Tri-County
Apartment House Owners Association,
Plaintiffs,

vs.

City of San Jose, City Council of
The City of San Jose, and Does One
through One Hundred, inclusive,
Defendants.

JUDGMENT

[Filed Feb. 26, 1980]

Plaintiff's motion for an order granting judgment on the pleadings came regularly on for hearing February 25, 1980, at 9 a.m., before this court, the Honorable Bruce F. Allen presiding. Burch Fitzpatrick, Esquire, appeared as counsel for plaintiffs, and Anthony C. Bennetti, Esquire, Deputy City Attorney, appeared on behalf of defendants. This court, having previously granted the defendants' general demurrer to that portion of the complaint attacking the constitutionality of Sections 5704.1 and 5704.2 of the San Jose Rental Dispute Mediation and Arbitration Ordinance, and having previously ruled that Subsection (c)(7) of Section 5703.28 and Section 5703.29 of the San Jose Rental

Dispute Mediation Arbitration Ordinance were unconstitutional, and having considered the memoranda for and against plaintiffs', the pleadings herein, and the subject ordinance, hereby grants the plaintiffs' motion for a judgment on the pleadings and hereby ORDERS, ADJUDGES and DECREES as follows:

1. Subsection (c)(7) of Section 5703.28 and Section 5703.29 of the San Jose Rental Dispute Mediation and Arbitration Ordinance are unconstitutional because they obligate private individuals to assume public burdens without just compensation in violation of the Fifth and Fourteenth Amendments of the United States Constitution and the analogous portions of the Constitution of the State of California.

2. The City of San Jose, its officers, agents, employees and the hearing officers appointed under the San Jose Rental Dispute Mediation and Arbitration Ordinance are hereby permanently enjoined and restrained from considering the hardship to a tenent in considering what rental increases are reasonable under the Mediation and Arbitration provisions provided for in the San Jose Rental Dispute Mediation and Arbitration Ordinance and Sections 5703.28(c)(7) and 5703.29 thereof.

3. Sections 5704.1 and 5704.2 of the San Jose Rental Dispute Mediation and Arbitration Ordinance, which provided for the imposition of a $3.75 a year fee on rental units to finance the administration of the ordinance, imposes the regulatory fee and not a special tax within the meaning of Section 4 of Article XIIIA of the State Constitution. Consequently, said sections are not unconstitutional nor in conflict with the State Constitution and the plaintiffs' complaint with respect to said sections is hereby dismissed and the plaintiffs' request for an injunction preventing the enforcement of said sections in selection of said fee is hereby denied.

4. Plaintiffs shall recover its cost in this action in the amount of $__________.

Dated: Feb. 26, 1980

/s/ BRUCE F. ALLEN
Bruce F. Allen
Judge of the Superior Court

Appendix D

In the Supreme Court of the
State of California
S.F. 24767
A011914
(Super. Ct. No. 435458)
Richard Pennell, Tri-County Apartment
House Owners Association,
Plaintiffs and Appellants,
vs.
City of San Jose, City Council of
the City of San Jose,
Defendants and Appellees.

Notice of Appeal to the Supreme Court of the United States

[Filed Oct. 29, 1986]

Notice is hereby given that Richard Pennell and Tri-County Apartment House Owners Association hereby appeal to the Supreme Court of the United States from that portion of the final judgment of the Supreme Court of the State of California entered in this action on August 11, 1986 which reversed the decision of the Santa Clara Superior Court.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Dated: October 29, 1986

Miller, Starr & Regalia
Burch Fitzpatrick
Gary E. Rosenberg
By: /s/ BURCH FITZPATRICK
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APPENDIX E

ORDINANCE NO. 19696

Ordinance of the City of San Jose Establishing the San Jose Rental Dispute Mediation and Arbitration Ordinance by Adding Chapter 7 to Article V of the San Jose Municipal Code.

NOW, THEREFORE, BE IT ORDAINED BY THE COUNCIL OF THE CITY OF SAN JOSE:

SECTION 1. The San Jose Municipal Code is hereby amended by adding Chapter 7 to Article V which shall read as follows:

Chapter 7. SAN JOSE RENTAL DISPUTE MEDIATION AND ARBITRATION ORDINANCE.

PART 1. GENERAL PROVISIONS.

5701.1 Title. This chapter shall be known as the San Jose Rental Dispute Mediation and Arbitration Ordinance.

5701.2 Declaration of Policy and Purposes. It is found and declared that there is a growing shortage of and increasing demand for housing in the City of San Jose. This circumstance coupled with increasing inflation, the rising cost of developing new housing, and other factors have put substantial upward pressure on residential rents.

In order to protect the health, safety and welfare of the citizens of San Jose, this ordinance is a necessary measure designed to alleviate some of the more immediate needs created by San Jose's housing situation. These needs include but are not limited to the prevention of excessive and unreasonable rent increases, the alleviation of undue hardship upon individual tenants, and the assurance to landlords of a fair and reasonable return on the value of their property.

5701.3 Severability of Provisions. If any provision or clause of this Chapter or the application thereof to any person is held to be invalid, such invalidity shall not affect the other provisions or applications of this Chapter which can be given effect without the invalid provision or application, and to this end, the provisions of this Chapter are declared to be severable.

PART 2. DEFINITIONS.

5702.1 General. Unless the context otherwise requires, the definitions set forth in this Part govern the construction of the Chapter.

5702.2 Capital Improvements. Capital improvements are those improvements which materially add to the value of the property, appreciably prolong its useful life, or adapt it to new uses, and which are required to be amortized over the useful life of the improvement of the building pursuant to the straight-line depreciation provisions of the Internal Revenue Code, and the regulations issued pursuant thereto.

5702.3 Commission. Commission means the San Jose Advisory Commission on Rents and the Rental Dispute Mediation and Arbitration Hearing Process.

5702.4 Costs of Operation and Maintenance. Costs of operation and maintenance shall mean all expenses, exclusive of costs of debt service and costs of capital improvements, incurred in the operation and maintenance of the rental unit and the building or complex of buildings of which it is a part together with common areas, including but not limited to: real estate taxes, business taxes and fees (including fees payable by landlords under this Chapter), insurance, sewer service charges, utilities, janitorial service, professional property management fees, interest costs of variable interest rate mortgages, pool maintenance, exterior building and grounds maintenance, supplies, equipment, refuse removal, elevator service, and security services or systems.

5702.5 Costs of Debt Service. Costs of debt service shall mean the periodic payment or payments due under any security or financing device which is applicable to the rental unit or the building or complex or other real property of which it is a part, including any fees, commissions, or other charges incurred in obtaining such financing which are required to be amortized for a period exceeding sixty (60) months pursuant to the Internal

Revenue Code and the regulations issued pursuant thereto. Nevertheless, costs of debt service shall not include adjustments in the interest costs of a variable interest rate mortgage after the indebtedness secured thereby is incurred.

5702.6 Costs of Rehabilitation. Costs of Rehabilitation shall mean the costs of any rehabilitation or repair work done on or in a rental unit or common area of the housing complex containing the rental unit and which work was done in order to comply with an order issued by the San Jose Building Department, the San Jose Director of Property and Code Enforcement, or the Fire Department, or to repair damage resulting from fire, earthquake, or other natural disaster.

5702.7 Hearing Officer. Hearing Officer shall mean a person designated by the Commission and the rules thereof who mediates or arbitrates rental increase disputes pursuant to the provisions of this Chapter.

5702.8 Housing Services. Housing services are those services provided and associated with the use or occupancy of a rental unit, including but not limited to, repairs, replacement, maintenance, painting, light, heat, water, elevator service, laundry facilities and privileges, janitorial service, refuse removal, furnishings, telephone, parking, and any other benefits, privileges or facilities.

5702.9 Landlord. Landlord means an owner, lessor, or sublessor, who receives or is entitled to receive rent for the use and occupancy of any rental unit or portion thereof, and the agent, representative, or successor of any of the foregoing.

5702.10 Rent. Rent is the consideration, including any bonus, benefit or gratuity, demanded or received by a landlord for or in connection with the use or occupancy of a rental unit, or the assignment of a lease for such a unit, including housing services or subletting.

5702.11 Rent Increase. A rent increase is any additional rent demanded of or paid by a tenant for a rental unit including any reduction in housing services without a corresponding reduction in the monies demanded or paid for rent.

5702.12 Rental Unit. A rental unit is a dwelling unit, mobilehome, or mobilehome lot offered or available for rent in the City of San Jose together with the land and appurtenant buildings thereto, and all housing services, privileges, and facilities supplied in connection with the use or occupancy thereof, which unit is located in a multiple dwelling, boarding house, lodging house or mobilehome park, as those terms are defined and used in Article XIX of this Code. The term "rental unit" shall not include:

(a) Rooms or accommodations in hotels, boarding houses, or lodging houses, which are rented to transient guests for a period of less than thirty (30) days;

(b) Housing accommodations in any hospital, convent, monastery, extended care facility, asylum, non-profit home for the aged, or in dormitories owned and operated by an institution of higher education, a high school or elementary school;

(c) Rental units owned or operated by any government agency or whose rent is subsidized by any government agency;

(d) Rental units, except mobilehomes and mobilehome lots, located in a building containing two (2) or fewer dwelling units.

5702.13 Tenant. A tenant is a person entitled by written or oral agreement or by sufferance to occupy a rental unit to the exclusion of others.

PART 3.

RENTAL DISPUTE MEDIATION AND ARBITRATION HEARING PROCESS

Topic 1. The Hearing Process—General Provisions.

5703.1 Hearing Process. There is hereby established the San Jose Rental Dispute Mediation and Arbitration Hearing Process, consisting of two phases: (1) the mediation phase and (2) the arbitration phase. Collectively, the two phases shall be referred to as the "Hearing Process."

5703.2 Increases Subject to Review. Except as hereinafter provided, any rent increase or combination of increases occurring after March 31, 1979, and prior to the effective date of this ordinance, which taken together with any increase which took effect in the twelve (12) month period immediately preceding such increase, exceeds an aggregate of eight percent (8%) shall be subject to review under the Hearing Process.

5703.3 Exceptions. The provisions of this Chapter shall not apply to the following:

(a) Rent or rent increases for new rental units first rented after the effective date of this ordinance.

(b) The rent of a rental unit following:

(1) a vacancy arising from the voluntary vacation of the rental unit on the part of a prior tenant, or

(2) a vacancy occurring because the prior tenant was evicted for nonpayment of rent, issuance by tenant of checks drawn against insufficient funds or closed accounts, chronically late payment of rent, or other material violation of a written rental agreement. A voluntary vacation of a rental unit shall not include situations where the vacancy arises from the landlord issuing a thirty (30) day notice to the prior tenant.

5703.4 Limitations on Rent Increases. After the effective date of this Chapter, the rent of any rental may not be increased more than once in any twelve (12) month period except as allowed under Section 5703.3(b).

5703.5 Exceptions to the Eight Percent (8%) Limitation. With respect to the first rent increase for a rental unit after the effective date of this ordinance, if a landlord has not raised rent for more than twelve (12) months prior to the latest increase, rental increases of greater than eight percent (8%) shall not be subject to this Chapter provided that such increases satisfy the following criteria:

(a) If the last rent increase was twelve (12) to twenty-four (24) months prior to the effective date of the current increase, a rental increase of up to fifteen percent (15%) shall be allowed.

(b) If the last increase was more than twenty-four (24) months prior to the current increase, a rental increase of up to twenty-one (21%) shall be allowed.

5703.6 Filing by Tenants. Any tenant who is subject to a rent increase which is not exempt under the provisions of this Chapter may invoke the San Jose Rental Dispute Mediation and Arbitration Hearing Process by filing a petition with the Commission.

5703.7 Petitions by Landlord. Any landlord whose rental units are subject to the provisions of this Chapter and who seeks to increase the rent of any rental unit or units by an amount subject to the provisions of this Chapter may invoke the Hearing Process by a petition filed with the Commission which shall be processed and heard in the same manner as provided herein for tenant applications, provided that the landlord shall notify, in writing, all tenants subject to such rental increase within five (5) working days of the filing of such petition and shall include in his filing with the Commission a list of names and addresses of all such tenants.

5703.8 Filing. The application for review must be filed on a petition form prescribed by the Commission and must be accompanied by such supporting material as the Commission shall prescribe, including but not limited to copy of the landlord's notice of rent increase.

5703.9 Filing Date. Except as provided hereinafter, a petition must be filed prior to the effective date of the increase stated in the notice to tenant; provided, however, that a tenant shall have at least ten (10) days after receipt of notice of rent increase from the landlord in which to file a petition.

5703.10. Consolidation of Petitions. As soon as possible after a petition has been filed with respect to rental units which are under common ownership or management and which are operated as a single housing complex, the Hearing Officer shall, to the greatest extent possible, consolidate petitions involving rental units which are under common ownership or management and which are operated as a single housing complex.

5703.11 Notices of Rent Increases. Whenever a landlord notifies a tenant or tenants of a proposed rental increase which exceeds eight percent (8%) of the then current rent of such tenant, the landlord shall also notify the tenant by the same type of notice or, at the landlord's option, in the same notice in a conspicuous manner of the tenant's right to utilize the City of San Jose's Rental Dispute Mediation and Arbitration Hearing Process and shall provide the current address and telephone number of the Commission.

Topic 2.
The Mediation Phase

5703.12 Effective Timely Filing of Petition. Providing that a completed petition is timely filed, concerning a rent increase subject to this Chapter, that portion of the requested rental increase (and only that portion) which exceeds eight percent (8%) shall not take effect unless and until such time as a Hearing Officer allows such increase or portion thereof pursuant to the provisions of this Chapter.

5703.13 Hearing Officer. A Hearing Officer shall be assigned to initially mediate any petition which is filed with the Commission. During this phase, such Hearing Officer shall be known as the Mediation Hearing Officer.

5703.14 Notice to Parties. The Mediation Hearing Officer shall set a preliminary hearing on the petition to be held within twenty-one (21) days of receipt of said petition by the Commission. Written notice of the hearing shall be given to the parties at least seven (7) days prior to the hearing.

5703.15 Time of Hearing. The hearing shall be held within twenty-one (21) days of the filing of the petition, or within such additional time as may be set by the Mediation Hearing Officer.

5703.16 Conduct of Hearing. The hearing shall be conducted by the Mediation Hearing Officer. Any party or their counsel may appear and offer such documents, testimony, written declarations, or other evidence as may be pertinent to the proceedings. A record of the proceedings shall be maintained for purposes of the arbitration phase or judicial review, as hereinafter provided.

5703.17 Determination of the Mediation Hearing Officer. Based upon the evidence presented at the hearing, the Mediation Hearing Officer shall make a determination whether or not, in light of all the evidence presented, the proposed rent increase is reasonable under the circumstances, in accordance with the standards set forth in Section 5703.28. The burden of proof regarding such reasonableness shall be on the landlord unless otherwise indicated.

5703.18 Findings and Determination. Within ten (10) days of the hearing, the Mediation Hearing Officer shall make his determination in writing that the proposed rent increase is reasonable under the circumstances or not, and shall make written findings of fact upon which such determination is based. Copies of the determination and the findings shall be mailed to the parties.

5703.19 Procedure Where Rent Increase Not Reasonable. If the Mediation Hearing Officer's determination is that the proposed rental increase is not reasonable under the circumstances, he shall require that a thirty (30) day mediation process be undertaken to resolve the areas of dispute. In such circumstances, the portion of the proposed rent increase (and only such portion) which exceeds eight percent (8%) shall be suspended during the period of mediation and subsequent arbitration, if any.

5703.20. Mediation Process. Where required, the Mediation Process shall mean that all parties and the Mediation Hearing Officer shall meet at least twice during the thirty (30) day period in an effort to resolve the dispute by mutual agreement. In the event that the parties agree to a specific rental increase, the Mediation Hearing Officer shall prepare a memorandum of agreement so specifying between the landlord and the affected tenants. If the mediation process fails to establish a mutually agreed amount of rental increase within thirty (30) days or sooner as hereinafter provided, the Mediation Hearing Officer shall request a best offer from each party, shall prepare a written report on the mediation process which includes all documentation and the record brought to that process by landlord and tenant and shall make a recommendation as to a reasonable rent increase. The case shall then be referred to arbitration as hereinafter provided. At any time during the mediation process, the Mediation hearing Officer may determine that there is an impasse, a substantial failure to mediate in good faith on the part of either party, or that further mediation is impractical or not likely to be of further value, in which event the Mediation Hearing Officer may immediately refer the matter to arbitration upon written notice to both parties of his intention to do so.

5703.21 Proceedings in the Event that Rent Increase is Reasonable. If the Mediation Hearing Officer determines that all or a portion of the proposed rent increase is reasonable under the circumstances, the Mediation Hearing Officer shall grant all or such prtion of the rent increase to be effective as of the time such increase would have been otherwise effective without reference to the provisions of this Chapter, pending the outcome of arbitration, if any. Any party may appeal the amount of the increase allowed to arbitration, but the tenant or tenants must pay the allowable rent increase pending resolution of the dispute. If neither party appeals within seven (7) days of the Mediation Hearing Officer's determination, his determination shall be final.

Topic 3.
The Arbitration Phase

5703.22. Invoking Arbitration. Arbitration may be invoked under this Chapter by the Mediation Hearing Officer as provided in Topic 2, or by a party by appeal after the determination that a rent increase is reasonable under the circumstances. The appeal of any party shall be in writing to the Mediation Hearing Officer and shall be delivered within seven (7) days of the determination by the Mediation Hearing Officer.

5703.23 The Arbitration Process. Within seven (7) days of an appeal by either party or the Mediation Hearing Officer's referral to arbitration, an arbitrator shall be appointed who shall conduct an initial hearing with all parties within such period. At this initial hearing, the report of the Mediation Hearing Officer shall be reviewed, the concerns of each party shall be discussed, and the arbitrator shall indicate the amount and nature of further documentation or evidence he will need from any party in order to reach a determination. Each party shall comply with the arbitrator's request for any information within ten (10) days of the intial hearing. The arbitrator may proceed under this topic regardless of whether any party defaults in the providing of any requested information.

5703.24 Arbitrator's Determination. After reviewing the record and any additional evidence requested of the parties which has been provided, the arbitrator shall determine the amount of allowable rental increase, if any, in accordance with the standards of Section 5703.28.

5703.25 Decision of the Arbitrator Final. The determination of the arbitrator shall be final, and shall be delivered to the parties in writing, together with written findings of fact supporting such determination within seventeen (17) days of the hearing provided in Section 5703.23. The arbitrator's allowance of disallowance of any rent increase or portion thereof may be reasonably conditioned in any manner necessary to effectuate the purposes of this Chapter.

Topic 4.
Provisions Applicable Both to the Mediation Phase and the Arbitration Phase.

5703.26 Hearing Officers. Hearing Officers may serve as either Mediation Hearing Officers or Arbitrators, but to the extent possible shall not be assigned to serve in both capacities with respect to petitions consolidated as the result of one particular increase for a rental unit or a series of units operated as a single housing complex.

5703.27. Applicability of Determination. No determination made under the provisions of this Chapter shall be effective with respect to any rental unit unless the tenant of such unit is a party to the proceeding.

5703.28 Standards of Reasonableness to be Applied to Rent Increases. Hearing Officers shall determine whether rent increases are reasonable under the circumstances taking into consideration that the purpose of this Ordinance is to permit landlords a fair and reasonable return on the value of their property while protecting tenants from arbitrary, capricious or unreasonable rent increases, and under certain circumstances, unjustified economic hardship. The Hearing Officer's determination shall be made with reference to the following standards:

(a) Increases Deemed Reasonable. Where the amount of the proposed rental increase consists only of passing through one or more of the following: (i) costs of capital improvements, (ii) increased costs of maintenance and operation, or (iii) costs of rehabilitation; plus no more than five percent (5%) of the monthly rent, they shall be deemed reasonable and the Hearing Officer shall allow the entire rental increase provided that:

(1) cost figures have been established to his reasonable satisfaction;

(2) the costs of capital improvements if any are averaged on a per unit basis and are amortized over a period not less than sixty (60) months;

(3) the costs of rehabilitiation if any are averaged on a per unit basis and are amortized over a period not less than thirty-six (36) months;

(4) each of the costs proposed to be passed through to tenants, whether it be costs of capital improvements, increased costs of operation and maintenance, or costs of rehabilitiation, bears a reasonable relationship to the purposes for which such costs were incurred and the value of the real property to which they are applied.

(b) When Costs of Debt Service Deemed to be Reasonable. Increased costs of debt service shall be deemed reasonable and allowed by the Hearing Officer where the aggregate amount of debt from whence they arise constitutes no more than seventy percent (70%) of the value of the property as established by a lender's appraisal, and no more than eighty percent (80%) of the

cost of such debt service is being passed through to the tenants. Where no lender's appraisal is available, the Hearing Officer may secure such appraisal to be paid for by the landlord as a cost of maintenance and operation.

(c) Standards Applicable to Rent Increases Which Exceed the Foregoing. When the amount of any rent increase or portion thereof exceeds any of the foregoing standards under subsections (a) or (b) of this Section, the Hearing Officer shall determine what is reasonable under the circumstances taking into account any of the following factors on which he has received information:

(1) In the case of increased costs of debt service due to a sale or refinancing of the rental units or the building or property of which the units are a part within twelve (12) months of the increase: (i) the arms length nature of the transaction, (ii) the landlord's rate of return on the investment, (iii) the frequency of past resale or refinances, and (iv) the extent to which prior rental increases hae made provisions for appreciation of asset value;

(2) the rental history of the unit or the complex of which it is a part, including: (i) the presence or absence of past increases, (ii) the frequency of past rent increases, (iii) the landlord's response to Proposition 13 savings, and (iv) the occupancy rate of the complex in comparison to comprobable units in the same general area;

(3) the physical condition of the rental unit or complex of which it is a part, including the quantity and quality of maintenance and repairs preformed during the last twelve (12) months;

(4) any increases or reduction of housing services since the last rental increase before the effective date of this Ordinance;

(5) other financial information which the landlord is willing to provide;

(6) existing market value of rents for units similarly situated;

(7) the hardship to a tenant, as provided in Section 5703.29.

5703.29 Hardship to Tenants. In the case of a rent increase or any portion thereof which exceeds the standard set in Section 5703.28(a) or (b), then with respect to such excess and whether or not to allow same to be part of the increase allowed under this Chapter, the Hearing Officer shall consider the economic and financial hardship imposed on the present tenant or tenants of the unit or units to which such increases apply. If, on balance, the Hearing Officer determines that the proposed increase constitutes an unreasonably severe financial or economic hardship of a particular tenant, he may order that the excess of the increase which is subject to consideration under subparagraph (c) of Section 5703.28, or any portion thereof, be disallowed. Any tenant whose household income and monthly housing expense meets the criteria established by the Housing Assistance Payments Program under Section 8, existing housing provisions of the Housing and Community Development Act of 1974 (P.L. 93-383) and the regulations pertaining thereto, shall be deemed to be suffering under financial and economic hardship which must be weighed in the Hearing Officer's determination. The burden of proof in establishing any other economic hardship shall be on the tenant.

5703.30 Quality of Rental Units. In any determination of what constitutes a reasonable rent increase under the circumstances, the Hearing Officer shall consider and weigh evidence establishing the nature and extent of any violations by either landlord or tenant of the San Jose Housing Code or the provisions of Section 1941.1 and 1941.2 of the California Civil Code. Any rent increase may be disallowed, reduced, or made subject to reasonable conditions, depending on the severity of such violations.

5703.31 Retrospective Application of Chapter. Anything provided elsewhere to the contrary notwithstanding this Chapter shall apply to rent increases effective prior to the effective date of this Ordinance and after March 31, 1979, as follows:

(a) The hardship provision of Section 5703.28(c) shall not apply to the costs of debt service arising from a good faith contract of sale or refinancing agreement prior to the effective date of this Ordinance which shall be allowed as any other costs of maintenance and operation, plus up to five percent (5%).

(b) Under no circumstances shall a landlord be required to refund rents collected between March 31, 1979, and the effective date of this Ordinance. However, an Arbitrator may establish a gross monthly rent at a decreased level pursuant to the guidelines of Section 5703.28(a), (b), (c). Such lower rent shall be effective for a period of twelve (12) months after the last increase effective before the effective date of this Ordinance.

(c) Any review of a rent increase which was effective prior to the effective date of this Ordinance shall be instituted no later than sixty (60) days after the effective date of this Ordinance.

PART 4. FEES.

5704.1 Fees. The costs of providing and administering the San Jose Rental Dispute Mediation and Arbitration Hearing Process shall be reimbursed to the General Fund by imposition of a fee chargeable against each rental unit in the City of San Jose subject to the provisions of this Chapter.

5704.2 Amount of Fee. There is hereby imposed on each rental unit, subject to the provisions of this Chapter, a fee of three dollars and seventy-five cents ($3.75) per year which shall be paid annually at the time at which the landlord's business license fee under Article VI or Article XII of this Code is due. Said fee is includable as a cost of maintenance and operation under the definition contained in Section 5702.4. The City Manager and the Commission shall report to the Council in time for budget hearings each year their recommendation as to the amount of such fee necessary to recover the costs of the Hearing Process.

PART 5.
THE SAN JOSE ADVISORY COMMISSION ON RENTS AND RENT MEDIATION AND ARBITRATION HEARING PROCESS

5705.1 Purpose. The purpose of the Commission shall be to oversee the operation of the Rental Dispute Mediation and Arbitration Hearing Process provided in this Chapter.

5705.2 Constitution. Membership shall consist of seven (7) members including two (2) tenants, two (2) landlords, and three (3) persons who are neither tenant not landlord.

5705.3 Term. Term of membership on the Commission shall be for two (2) years.

5705.4 Powers and Duties. The powers and duties of the Commission shall be as follows:

(a) To adopt rules and regulations and amendments thereto which are necessary to operate and administer this Chapter and which are consistent with the goals and purposes of this Chapter;

(b) To make recommendations to the City Council regarding substantive changes in this Ordinance;

(c) To prepare a semi-annual report to the City Council on the operations of the Rental Dispute Mediation and Arbitration Hearing Process;

(d) To make recommendations to the Council and to the City Manager as to staffing and the amount of funds necessary to operate and maintain the Hearing Process;

(e) The Commission shall elect a Chairman and Vice-Chairman from among its members.

5705.5. Compensation. Compensation, if any, for the Commission, shall be set by the City Council.

5705.6 Quorum. A quorum for the transaction of official business shall consist of a majority of the total Commission members. No action may be taken by the Commission at any meeting attended by less than the quorum. A decision by the Commission shall require a majority of all members of the Commission.

5705.7 Staffing. The City Manager of his designee shall provide staff services to the Commission, including Hearing Officer.

PART 6. ENFORCEMENT

5706.1 Retaliatory Eviction. Possession of a rental unit shall not be recovered by a landlord from a tenant who is not otherwise in default as to the terms of occupancy of said unit, if either:

(a) the landlord's dominant motive in seeking to recover possession of such rental unit is retaliation against the tenant for exercising his or her rights under this Chapter; or

(b) the dominant motive of the landlord in seeking to recover possession of such rental unit is to evade the purposes of this Chapter.

5606.2 Nonwaiver. Any waiver or purported waiver by a tenant of rights granted under this Chapter prior to the time when such rights may be exercised shall be void as contrary to public policy.

5706.3 Retaliation: Misdemeanor. It shall be unlawful for any landlord to evict a tenant in retaliation for tenant organizing and/or tenants petitioning government for rent relief.

5706.4 Excessive Rents or Demands Therefor: Misdemeanor. Any landlord found to have demanded, accepted, received or retained any rent in excess of the maximum rent allowed by the decision of a Hearing Officer under this Chapter shall be guilty of a misdemeanor.

5706.5 Excessive Rents: Civil Penalties. Any person found to have demanded, accepted, received or retained any payment of rent in excess of the maximum rent allowed by the decision of a Hearing Officer under this Chapter or in violation of the notice provisions of Section 5703.11 shall be liable to the tenant from whom such payment was demanded, accepted, received or retained, for the amount such payment exceeded the maximum rent, plus damages as determined, not to exceed five hundred dollars ($500) or three (3) times the amount by which such payment exceeded the maximum rent, whichever is greater. Remedies provided in this paragraph are in addition to any other legal remedies and are not intended to be exclusive.

SECTION 2. Article II of the San Jose Municipal Code is hereby amended by adding Topic 35 to Part 2 of Chapter 2 of said Article to be numbered and to read as follows:

2249.100 The San Jose Advisory Commission on Rents and Rental Dispute Mediation and Arbitration Hearing Process is hereby established.

2249.101 Powers and Duties. The powers and duties of the Advisory Commission established by Section 2249.100 hereof shall be as provided in Chapter 7 of Article V of this code.

SECTION 3. This City Council strongly urges that the question of whether or not this Ordinance should remain in effect be placed before the voters of the City of San Jose for an advisory vote at the general municipal election held in 1982.

PASSED FOR PUBLICATION OF TITLE this 10th day of July, 1979, by the following vote:

AYES—Estruth, Garza, Self, Williams.

NOES—Hayes.

ABSENT—NONE.

DISQUAL—McEnery and Pegram.

JANET GRAY HAYES,
Mayor

ATTEST:
FRANCIS L. GREINER,
City Clerk

MOTION

Supreme Court, U.S.
FILED
JAN 2 1987
JOSEPH F. SPANIOL, JR.
CLERK

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No. 86-753

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1986

RICHARD PENNELL and
TRI-COUNTY APARTMENT HOUSE OWNERS ASSOCIATION,
Appellants,

vs.

CITY OF SAN JOSE and CITY COUNCIL OF
THE CITY OF SAN JOSE,
Appellees.

**On Appeal from the Supreme Court
of the State of California**

MOTION TO DISMISS OR AFFIRM

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21 pp

Question Presented

Whether a unique rent control ordinance that guarantees the landlord the constitutionally mandated fair return is unconstitutional, nevertheless, because it allows, if the landlord seeks an even higher rent increase, consideration of tenant hardship as one of several factors.

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No. 86-753

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Appellants,

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THE CITY OF SAN JOSE,
Appellees.

On Appeal from the Supreme Court of the State of California

MOTION TO DISMISS OR AFFIRM

Appellees, the City of San Jose and the City Council of the City of San Jose, respectfully request this Honorable Court to dismiss the Appeal now pending on the ground that the federal questions presented are so unsubstantial as to require no further argument, or in the alternative, to affirm the decision of the California Supreme Court.

STATEMENT OF THE CASE

This Appeal attacks the facial validity of a non-confiscatory rent control ordinance enacted by the City of San Jose. Specifically, it asserts that this ordinance is unconstitutional, despite the fact that the ordinance provides for the landlord to receive the constitutionally mandated fair return, because the alternative method for determining permissible rent increases above the fair return includes "tenant hardship" as a factor.

The City of San Jose has developed a unique, rent control ordinance to meet its own needs.[1] Because of its complex structure, it is necessary to consider the ordinance as a whole rather than to consider the challenged provision, subsection (c) of § 5703.28, out of context.

The ordinance was adopted as "a necessary measure designed to alleviate some of the more immediate needs created by San Jose's housing situation." San Jose Municipal Code § 5701.2.[2] Three such needs are specified:

1. Prevention of excessive and unreasonable rent increases;

2. The alleviation of undue hardship upon individual tenants; and

3. Assurance to landlords of a fair and reasonable return on the value of their property.

The San Jose Ordinance entitles the landlord of a regulated unit to an annual rent increase that is reasonable as determined by the *highest* of four separate methods of computation. See §§ 5703.2, 5703.28(a), 5703.28(b) and 5703.28(c).

Section 5703.2 provides that the landlord may raise the rent of a regulated unit by as much as eight percent (8%) per year without even becoming subject to review under the ordinance. The California Supreme Court characterized this 8% as generous. *Pennell v. City of San Jose*, 42 Cal.3d 365, 374, 228 Cal.Rptr. 726, 721 P.2d 1111 (1986).

If the landlord wants to impose a rent increase greater than 8%, the landlord, at his election, can either invoke a hearing process by filing a petition, or he may simply give the tenant written notice of the rent increase. If he chooses to give notice, the rent increase, irrespective of amount, automatically becomes operative unless, within specified time limits, the tenant files a petition to have the reasonableness of the increase determined by a Hearing Officer. *See* § 5703.9.

In computing the permissible rent increase, the Hearing Officer is required to determine:

> whether rent increases are reasonable *under the circumstances* taking into consideration that the purpose of this ordinance is to permit landlords a fair and reasonable return on the value of their property while protecting tenants from arbitrary, capricious or unreasonable rent increases, and under certain circumstances, unjustified economic hardship.

Section 5703.28 (emphasis added).

There are three methods of computing the amount of the rent increase, in excess of 8%, which is reasonable under the circumstances:

1. Section 5703.28(a) entitles a landlord to a rent increase greater than eight percent (8%), if the increase consists of five percent (5%) of the monthly rent *plus* a pass-through of:

(a) capital improvement costs averaged on a per unit basis and amortized over not less than sixty (60) months; and

---

[1] The California Supreme Court pointed out that it is "aware of no other rent control ordinance that contains a tenant financial hardship provision, let alone one that operates like this one." *Pennell v. City of San Jose*, 42 Cal.3d 365, 371, 228 Cal.Rptr. 726, 721 P.2d 1111 (1986).

[2] All statutory references are to the San Jose Municipal Code unless otherwise specified. See Appendix E, Appellants' Jurisdictional Statement.

(b) increased costs of maintenance and operation; and

(c) costs of rehabilitation, averaged per unit and amortized over not less than thirty six (36) months.

2. Section 5703.28(b) entitles a landlord to a rent increase greater than eight percent (8%), if the increase consists of increased costs of debt service, where the aggregate debt does not exceed seventy percent (70%) of the property's value and not more than eighty percent (80%) of the debt service is passed through.

3. Section 5703.28(c) sets forth the standards applicable to rent increases in excess of the other methodologies. The Hearing Officer is directed to determine what is reasonable under the circumstances by taking into account *any* of the listed factors about which he has received information. The factors include such items as the rental history of the unit or complex, the presence or absence of past increases, the frequency of past increases, the landlord's response to Proposition 13 savings, the occupancy rate of the complex in comparison to comparable units in the general area, the quantity and quality of maintenance and repairs performed and the existing market value of rents similarly situated. In addition, subparagraph (5) enables the Hearing Officer to consider "other financial information which the landlord is willing to provide," in order to determine if there is hardship to the landlord. The seventh and last factor is the "hardship to a tenant" provision that Appellants are challenging here.

In applying § 5703.28(c), the Hearing Officer is directed to consider the economic and financial hardship imposed on the present tenant:

> If, *on balance*, the Hearing Officer determines that the proposed increase constitutes an *unreasonably* severe financial or economic hardship of a particular tenant, he *may* order that the excess of the increase which is subject to consideration under subparagraph (c) of Section 5703.28, or any portion thereof be disallowed.

Section 5703.29 (emphasis added).

Section 5703.29 also places the burden of proving economic hardship on the tenant except that any tenant whose household income and monthly household expenses meet the criteria established by the Housing Assistance Payments Program under Section 8 of the Housing and Community Development Act of 1974 is *deemed* to be suffering under financial and economic hardship that must be *weighed* in the Hearing Officer's determination. This "HUD" provision simply avoids the burden of proof by creating an unrebuttable presumption of hardship. However, this section does not override the need to weigh and balance relevant factors, nor does it require a Hearing Officer to disallow any portion of a rent increase.

It needs to be stressed that such tenant hardship is a relevant consideration only with respect to whether and to what extent the landlord will be allowed an increase in *excess* of the increases as determined under § 5703.28 subsections (a) and (b). Under the standard of "fair and reasonable under the circumstances," the landlord is required to receive *at least* the constitutionally mandated fair return. The weighing and balancing test at issue relates only to the amount above that constitutional base. No provision of the ordinance forecloses consideration of *all* the relevant factors in § 5703.28(c), nor does proof of tenant hardship require a disallowance of all or any portion of the excess. The rental increase is therefore not "dependent" on the tenant's financial hardship. The tenant hardship is merely a factor that must be weighed in determining the amount of rent, permissible above the constitutionally required fair return.

I. NO SUBSTANTIAL FEDERAL QUESTION IS PRESENTED

The law is clear and well settled: a municipal rent control regulation is a valid exercise of the police power if it is reasonably calculated to eliminate excessive rents and if it provides landlords with a just and reasonable return on their property. *Fisher v. City of Berkeley*, 37 Cal.3d 644, 209 Cal.Rptr. 682, 693 P.2d 261 (1984), *aff'd*, ___ U.S. ____, 106 S.Ct. 1045 (1986)[3]; *Birkenfeld v. City of Berkeley*, 17 Cal.3d 129, 130 Cal.Rptr. 465, 550 P.2d 1001 (1976). *See Eisen v. Eastman*, 421 F.2d 560, 567 (1969). The San Jose Ordinance unquestionably meets this test.

A. The San Jose Ordinance Guarantees the Constitutionally Required Return.

A rent control ordinance will be found invalid on its face *only* when its terms will not permit it to be administered in a way that avoids confiscatory results. *Birkenfeld v. City of Berkeley*, 17 Cal.3d at 165, 130 Cal.Rptr. at 491, 550 P.2d at 1027. *See also Hutton Park Gardens v. Town Council*, 68 N.J. 543, 350 A.2d 1 (1975). Courts are to assume that an ordinance, not confiscatory on its face will be constitutionally administered.

In adopting rent control ordinances, cities are not obligated either by the California or the Federal Constitution "to fix rents by application of any particular method or formula." *Fisher v. City of Berkeley*, 37 Cal.3d at 680, 209 Cal.Rptr. at 711, 693 P.2d at 290. In *Fisher*, the California Supreme Court set out what it termed the "veritable smorgasbord of administrative standards by which to determine rent ceilings." *Id.* at 679-80, 209 Cal.Rptr. at 711, 693 P.2d at 290.

By its own terms, the San Jose Ordinance is required to be applied according to "Standards of Reasonableness" set forth in § 5703.28. The standards are predicated on the direction to the Hearing Officers to determine whether rent increases are reasonable under the circumstances, taking into consideration that the purpose of this ordinance is to permit landlords a fair and reasonable return on the value of their property, while protecting tenants from arbitrary, capricious or unreasonable rent increases, and, under certain circumstances, unjustified economic hardship.

Even Appellants do not contend that the San Jose Ordinance is confiscatory. This ordinance ensures all landlords a constitutional fair return and, moreover, allows the Hearing Officer to grant landlords an additional increase above that constitutionally required. Tenant hardship is only one factor in determining the amount of any such additional increase.

B. Consideration of Tenant Hardship Does Not Result In a Taking.

Police power legislation results in a "taking" only when the owner of the property has been deprived of substantially all reasonable use of the property. *Agins v. City of Tiburon*, 24 Cal.3d 266, 277, 157 Cal.Rptr. 372, 598 P.2d 25 (1979), *aff'd*, 447 U.S. 255 (1980). Even a significant diminution in value is insufficient to establish such a taking. *Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1926). It is well established that there is no taking merely because the owner's best or most profitable use of property has been denied. *Penn Central Transp. Co. v. New York City*, 438 U.S. 104 (1978).

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[3] As noted by Appellants, on May 28, 1985, at 105 S.Ct. 2653, the appeal of *Fisher* was dismissed with regard to the questions challenging the constitutionality of a rent control ordinance with a return on investment standard.

Any price setting regulation has the inevitable effect of reducing the value of regulated properties, but it has long been held that such reduction in property value does not by itself render the regulation unconstitutional. *Fisher v. City of Berkeley*, 37 Cal.3d at 686, 209 Cal.Rptr. at 715, 693 P.2d at 294. See also *Permian Basin Area Rate Cases*, 390 U.S. 747, 769, *reh'g denied*, 392 U.S. 917 (1968); *Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 601 (1943). Where a property owner receives a fair return, by definition, there is no taking. See *Penn Central Transp. Co. v. New York City*, 438 U.S. at 135-37.

Appellants have formulated a novel theory that by enacting the tenant hardship provision, San Jose is acting within its "enterprise capacity" rather than its "arbitral capacity" and therefore has violated the Just Compensation Clause of the Constitution. No authority is cited in support of this amazing proposition.

The seminal exposition of the "enterprise/arbitral" approach is found in Sax, *Taking and Police Power*, 74 Yale L.J. 36 (1964). Professor Sax has generally been quoted by the occasional courts that have attempted to apply this approach.[4] See *Rochester Tel. Corp. v. Village of Fairport*, 446 N.Y.S.2d 823, 825 (1982); *Fifth Avenue Corp. v. Washington County*, 581 P.2d 50, 62-63 (Or. 1976). Professor Sax defines the enterprise role as the "economic function of providing for and maintaining the material plant, whether that be the state capitol or a retail liquor store." *Sax, supra*, at 62. The arbitral role is when the government "governs." "That is, it mediates the disputes of various citizens and groups within the society, and it resolves the conflict among competing and conflicting alternatives. Typically in this function . . . as between tenant and landlord it may adjust prices." *Id.* at 62-63. Clearly, the San Jose Ordinance fits squarely in the arbitral category. According to Professor Sax, losses, however severe, which are incurred when government is acting within its arbitral capacity result from an exercise of the police power and are non-compensable. *Id.* at 63. This theory lends no support for Appellants' contention that the tenant hardship provision results in a taking; to the contrary, it fully supports Appellees' position.

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[4] Interestingly, Professor Sax has significantly modified his position regarding the distinction between "enterprise" and "arbitral" roles in his subsequent article, Sax, *Takings, Private Property and Public Rights*, 81 Yale L.J. 149 (1971). Professor Sax notes "[t]he modification which follows from a new notion of property rights is substantial. Much of what was formerly deemed a taking is better seen as an exercise of the police power in vindication of what shall be called 'public rights'." *Id.* at 151.

C. Appellants Misconstrue the Hardship Provision.

It is a basic principle that legislation regulating prices or otherwise restricting contractual or property rights is within the police power if its operative provisions are reasonably related to the accomplishment of a legitimate government purpose. In this respect, rent control legislation is indistinguishable from other types of government price regulation. *Birkenfeld v. City of Berkeley*, 17 Cal.3d 129, 130 Cal.Rptr. 465, 550 P.2d 1001 (1976); *Hutton Park Gardens v. Town Council*, 68 N.J. 543, 350 A.2d 1 (1975).

This Court stated in *Power Comm'n v. Pipeline Co.*, 315 U.S. 575 (1942), that "[t]he Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas." *Id.* at 586. The method of regulating prices is immaterial as long as the result achieved is constitutionally acceptable. *Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. at 602.

In reviewing price controls, this Court found the rate-making function involves pragmatic adjustments. It is the result reached, not the method employed, that is controlling. The fact that the method employed to reach the result may contain certain infirmities is not important. *Id.*

All rent control has the effect of requiring landlords to "subsidize" tenants to the extent of the difference between unregulated market rents and regulated fair return rents. As this Honorable Court stated in *Fisher v. City of Berkeley*, ____ U. S. ____, 106 S.Ct. 1045 (1986), "the function of government may often be to tamper with free markets, correcting their failures and aiding their victims." *Id.* at 1048.

It is axiomatic that determination of what level of return is "just and reasonable" involves evaluation not only of the interests of the investor but also of the interests of the consumer and of the general public sought to be advanced by the regulatory legislation. *Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. at 603; *Hutton Park Gardens v. Town Council*, 68 N.J. at 565, 350 A.2d at 15.

As pointed out in *Cotati Alliance for Better Housing v. City of Cotati*, 148 Cal.App.3d 280, 195 Cal.Rptr. 825 (1983):

> The purpose of rent control is to permit an efficient landlord to pay all actual and reasonable expenses and receive a fair profit while, at the same time, protecting the public interest in having affordable and properly maintained rental housing available to the citizens of the community.

Id. at 296, 195 Cal.Rptr. at 835.

The Court in *Cotati* further stated that the general purpose of rent control laws is to prevent exploitation of housing shortages by imposing excess rent charges. It pointed to the problems created by California's continuing population growth and lack of housing. Certainly those who can least afford to pay for housing feel the housing crunch the most. "Prevention of the exploitation of shortages of available housing by precluding excessive rent is a legitimate governmental purpose." *Id.* at 293, 195 Cal.Rptr. at 833.

Appellants argue that tenant hardship is irrelevant to the policy of preventing unreasonable or excessive rent increases. Appellants, however, view the concept of unreasonable or excessive rent only from the landlord's perspective. In taking this position, Appellants ignore the public policy interest of San Jose's Ordinance, which not only is intended to protect tenants from arbitrary or capricious rent increases, but under certain circumstances, from *unjustified* economic hardship. From this perspective, an increase that creates an *unjustified* economic hardship to the tenant is unreasonable or excessive.

The San Jose Ordinance constitutionally could have been structured to allow the landlord no more than the minimal constitutionally required fair return. Instead, under § 5703.28(c), the landlord is given the option of receiving an increment greater than the fair return. If this increment is reduced or unavailable in some individual cases because it would contravene the public policy of avoiding unreasonable rent increases, this fact does not make the ordinance unconstitutional.

Appellants mischaracterize the function of the tenant hardship provision in the San Jose Ordinance. It does not, as stated by Appellants, "shift the burden of providing financial assistance to poor renters from the public at large to individual property owners." Appellant's Jurisdictional Statement at 6. Instead, the ordinance permits both the financial information provided by the landlord, § 5703.28(c)(5), and the tenant hardship information, § 5703.28(c)(7), to be weighed as factors in determining the increment of rent, above the minimum that is constitutionally required, which should be allowed as fair and reasonable under the circumstances and that therefore is not unreasonable or excessive.

The instant case is clearly distinguishable from the New Jersey cases relied on by Appellants. See *Helmsley v. Borough of Fort Lee*, 78 N.J. 200, 394 A.2d 65 (1978); *Property Owners Ass'n v. Township of North Bergen*, 74 N.J. 327, 378 A.2d 25 (1977). A careful reading of these cases shows, as pointed out by the California Supreme Court below, these cases involve rent control ordinances that *do not* assure the landlord of a constitutional return. *Pennell v. City of San Jose*, 42 Cal.3d at 372-73 n.9, 228 Cal.Rptr. at 731, 721 P.2d at 1116. The formulas in the *North Bergen* and *Helmsley* cases reduce the return, without limitation, based on tenant income.

Similarly, Appellants argue that the "tenant hardship" provision is tantamount to forcing landlords wrongfully to bear "the cost of the operation of state functions." Appellant's Jurisdictional Statement at 13. In support of this contention, Appellants cite a line of cases including *In re Jerald C.*, 36 Cal.3d 1, 201 Cal.Rptr. 342, 678 P.2d 917 (1984) and *Department of Mental Hygiene v. Kirchner*, 60 Cal.2d 716, 36 Cal.Rptr. 488, 388 P.2d 720 (1964). These cases set forth the court-created doctrine that under California law, the maintenance of the mentally ill is the responsibility of the state and therefore charging relatives for that care is a wrongful species of taxation. The California Supreme Court has not chosen to expand this doctrine into other areas. Nonetheless, Appellants contend that it is applicable in this case.

This line of argument was completely rejected by the California Supreme Court below after a fairly detailed discussion. *Pennell v. City of San Jose*, 42 Cal.3d at 371-73, 228 Cal.Rptr. at 730-31, 721 P.2d at 1115-16. The problem with Appellants' analogy is that it assumes the purpose of the hardship provision is to require that landlords take over a governmental responsibility, i.e., provision of affordable housing. Not only is there no authority for the proposition that the provision of affordable housing is an institutional obligation of local government, but most assuredly the tenant hard ship provision does not, in any way, require the landlord to take over any such responsibility. Tenant hardship is merely one factor to be weighed in determining a rent that is fair and reasonable under the circumstances.

The San Jose Ordinance assures the landlord a fair and reasonable return. The increment of return beyond the constitutional minimum is tempered by the interest of the individual tenant and the public welfare goal to ensure safe and decent housing for all citizens. As set forth in San Jose Municipal Code § 5701.2, this ordinance is expressly intended for multiple purposes including the prevention of excessive and unreasonable rent increases and the alleviation of undue hardship upon *individual* tenants, not just the assurance to landlords of a fair and reasonable return on the value of the property.[5] In this, the decade of the homeless, it cannot be argued that concern for individual tenants at the lower end of the economic scale is not a legitimate public interest.

D. San Jose's Ordinance Does Not Violate Equal Protection.

Equal protection is not denied simply because an ordinance treats one class of persons differently from another. Where there is no suspect classification and purely economic interests are involved, a municipality may impose any distinction which bears some "rational relationship" to a legitimate public purpose. *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456 (1981). See also *Schad v. Mt. Ephraim*, 452 U.S. 61, 68 (1981).

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[5] This purpose is one of several factors which makes the San Jose Ordinance so very different from other rent conrol ordinances. It is noteworthy that no City has filed an Amicus brief on behalf of Appellees at any stage of the proceedings thus far.

The case of *Nebbia v. New York*, 291 U.S. 502 (1933), still stands as the principal authority on the question of price control. In that case, this Court determined that a difference in the price paid for the sale of milk by a grocer and the price fixed for sale by distributors delivering milk to customers is based on a valid distinction between the two types of merchants and therefore does not deny the grocer equal protection. Price control is unconstitutional only if it is arbitrary, discriminatory or demonstrably irrelevant to the policy the adopting agency is free to adopt, and not because it creates some disparate treatment.

Similarly, in *Permian Basin Area Rate Cases*, 390 U.S. 747, *reh'g denied*, 392 U.S. 917 (1968), this Court found no constitutional defect merely because high cost operators were more seriously affected than other operators.

There is no constitutional requirement that all of a class of merchants need equally be subject to price control. Equal protection is not denied merely because some landlords receive rents different from those received by other similarly situated landlords, so long as the result is non-confiscatory and there is a rational basis for the distinction. *Cotati Alliance for Better Housing v. City of Cotati*, 148 Cal.App.3d 280, 195 Cal.Rptr. 825 (1983).

During the second World War, the federal government adopted the Emergency Price Control Act of 1942. Pursuant to the authority in that Act, the administrator declared various areas of the country as "defense rental areas." The declaration stated that defense activities had resulted in an increase in housing rents in the defense rental areas, and therefore, it was necessary and proper to effectuate rent control. In assessing a constitutional challenge to that authority, this Court stated that under price control, a member of the class that is regulated may suffer economic losses not shared by others, but that is no barrier to the exercise of police power. *Bowles v. Willingham*, 321 U.S. 503 (1944).

Regulation inevitably results in some disparate treatment because it is applicable in certain circumstances and not in others. Rent control is no different than other types of economic regulation. For example, if an ordinance uses a return on investment standard, then there will be a different rent ceiling for comparably valued rental units. However, equal protection is not denied simply because an ordinance treats one class of persons differently from another. Courts consistently defer to legislative determinations as to the desirability of such distinctions. *Fisher v. City of Berkeley*, 37 Cal.3d at 685, 209 Cal.Rptr. at 714, 693 P.2d at 293. See also *Birkenfeld v. City of Berkeley*, 17 Cal.3d 129, 130 Cal.Rptr. 465, 550 P.2d 1001 (1976).

Certainly a city could constitutionally choose to regulate the rents charged for low- and medium-priced apartments and not to regulate the rents of high-priced units. As the California Supreme Court pointed out, San Jose's Ordinance accomplishes that purpose in a more precise fashion by differentiating between hardship and non-hardship tenants on the basis of individual information and not merely on the basis of the price of the unit. *Pennell v. City of San Jose*, 42 Cal.3d at 374, 228 Cal.Rptr. at 732, 721 P.2d at 1117. The California Supreme Court found this ordinance to be "more finely tailored to local needs than 'across the board' rent control" because it offers "the potential for even more liberal increases to those whose tenants can bear the additional increase without financial hardship." *Id.* at 372-73, 228 Cal.Rptr. at 732, 721 P.2d at 1117.

E. The Real Dispute In This Case Relates To The Wisdom Of The Policy Behind The Ordinance.

The San Jose Ordinance would certainly be constitutional if it allowed *merely* the constitutionally required return. Instead, the ordinance allows the landlord an additional increment of return which may be reduced or denied if it would pose a financial hardship on a particular tenant.

Appellants do not like the ordinance that San Jose has chosen to adopt. They assert that instead of using rent control, the City could have imposed a tax that would result in a fairer method for spreading the "welfare" burden. However, it is basic to our system of law that whenever an ordinance is not arbitrary or discriminatory, the courts must not deal with the wisdom of the policy or the practicability of the law. *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 469 (1981). See also *Nebbia v. New York*, 291 U.S. 502 (1933). These decisions are more properly left to local officials.

Appellants, in urging this Court to review this case, are really requesting this Court to decide the wisdom and utility of the challenged provision. It is not the function of the United States Supreme Court to substitute its judgment for a local legislative decision and, as such, this Appeal does not raise a substantial federal question.

CONCLUSION

This case does not raise a substantial federal question. Therefore, for the reasons stated above, this Court should dismiss this appeal or affirm the decision of the California Supreme Court.

Dated: December ____, 1986

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AMICUS CURIAE

BRIEF

MOTION FILED

DEC 19 1986

86-753

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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

RICHARD PENNELL and
TRI-COUNTY APARTMENT
HOUSE OWNERS ASSOCIATION,
Appellants,

vs.

CITY OF SAN JOSE and CITY
COUNCIL OF THE CITY OF SAN JOSE,
Appellees.

ON APPEAL FROM THE SUPREME COURT
OF THE STATE OF CALIFORNIA

MOTION FOR LEAVE TO FILE A BRIEF AMICUS CURIAE AND BRIEF AMICUS CURIAE OF THE CALIFORNIA ASSOCIATION OF REALTORS ® IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

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Appellees.

ON APPEAL FROM THE SUPREME COURT
OF THE STATE OF CALIFORNIA

MOTION OF

CALIFORNIA ASSOCIATION OF REALTORS®

FOR LEAVE TO FILE AN AMICUS CURIAE BRIEF

IN SUPPORT OF APPELLANT'S

JURISDICTIONAL STATEMENT

Pursuant to Supreme Court Rule Nos. 36.1 and 42.2(b), CALIFORNIA ASSOCIATION OF REALTORS® respectfully moves this Court for leave to file the attached amicus curiae brief in support of appellants, Richard Pennell and Tri-County Apartment House Owners Association.

CALIFORNIA ASSOCIATION OF REALTORS® (C.A.R.) is a voluntary trade association whose members consist of Boards of Realtors® in California and those persons licensed by the State of California as real estate brokers and salespersons who are members of local boards. C.A.R.'s members are in the business of buying, selling, and managing residential rental units on a daily basis.

C.A.R. believes this is a case that goes to the very heart of private property rights and constitutional protections of due process and equal protection. C.A.R. represents a major portion of the real estate industry which is impacted by the decision of the California Supreme Court in this case, *Pennell v. City of San Jose*, 42 Cal.3d 365 (1986).

This Court is presented with a question which has far-reaching effects on the real estate industry: whether a private property owner can be mandated by a municipality to subsidize low-income tenants by not allowing the landlord to receive a just and reasonable return on his property.

According to the 1980 Census, Bureau of Census, U.S. Dept. of Commerce, *Structural Characteristics of the Housing Inventory,* In 3 *1980 Census of Housing* Ch.4 (1984), there are 28,593,273 renter-occupied housing units, approximately 32% of all housing units in the United States. Realtors® are involved in one capacity or another in an overwhelming majority of transactions relating to those units. Realtors® act as agents for the buyers and sellers of such units; they also act as property managers for the landlord of such units. The decision of this Court will impact on Realtors® significantly.

If the California decision is left standing, the Realtor® is left with conflicting signs regarding disclosure responsibilities. According to California law, real estate licensees are required to disclose all known material facts about a property to potential purchasers, *Lingsch v. Savage,* 213 Cal.App.2d 729 (1963). Is the Realtor® representing a buyer or seller of residential rental units required to disclose to a potential purchaser the financial background of all tenants with a warning that there may be low-income tenants in the units which could reduce the return on the property? When does the agent's fiduciary duty to disclose material facts to his or her client collide with the concept of nondiscrimination against the low-income tenant?

The California Supreme Court has added a new factor for consideration in the purchase of residential rental units -- the financial hardship of the individual tenants inhabiting the units. Discrimination against a class of persons is an activity that Court has stated a landlord cannot engage in when screening tenants; however, it is now stating that this same class of renters can be considered in denying rental increases.

C.A.R. believes that this Court will benefit from additional briefing of the policies in support of invalidating the California rule requiring a landlord to subsidize the low-income tenant.

C.A.R. respectfully requests that its motion to file the attached amicus curiae brief be granted.

DATED: December 5, 1986

Respectfully submitted,

William M. Pfeiffer,
General Counsel

Judith K. Herzberg,
Counsel

By Judith K. Herzberg

Consent to file this brief has not been granted by the Appellee, City of San Jose, because they stated, ". . . it would not be in [their] best interest." A request of the City Attorney's office was made on December 1, 1986, and was rejected. Counsel for Appellants consented to the filing of a brief in support of its Jurisdictional Statement on November 25, 1986.

No.

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ON APPEAL FROM THE SUPREME COURT
OF THE STATE OF CALIFORNIA

INTEREST OF AMICUS CURIAE

Pursuant to Supreme Court Rule 36, the CALIFORNIA ASSOCIATION OF REALTORS® respectfully submits this amicus curiae brief in support of Appellants, Richard Pennell and Tri-County Apartment House Owners Association.

Amicus curiae CALIFORNIA ASSOCIATION OF REALTORS® (C.A.R.) is a voluntary trade association whose members consist of Boards of Realtors® in California and those persons licensed by the State of California as real estate brokers and salespersons who are members of local boards. C.A.R. is the largest state trade association in the United States and has over 180 affiliated Boards of Realtors® and over 100,000 members.

The mission of C.A.R. is to serve in developing and promoting programs and services that will enhance the members' freedom and ability to conduct their individual businesses sucessfully with integrity and competency. Moreover, C.A.R. serves to promote, through collective action, the preservation of real property rights.

C.A.R. is of the belief that the continuing demand for rental housing can best be met by private investors willing to make long-term capital risks. We support a mutually beneficial owner-rental occupant relationship which will encourage a continuing supply of adequate and affordable housing.

The California rule that requires a landlord to subsidize the welfare of low-income tenants by preventing rental increases because of an individual tenant's economic hardship has far-reaching significance to the real estate industry engaged in the purchase, sale, and management of residential rental property. The California rule allows municipalities to impose regulations that deprive a private property landowner a just and reasonable return on his property in violation of established law.

Counsel for C.A.R. are familiar with the questions involved and the scope of their presentation and believe that further argument on the issues discussed by this amicus brief will be helpful to this Court.

ARGUMENT

RENT REGULATIONS THAT COMPEL INDIVIDUAL PROPERTY OWNERS TO SUBSIDIZE LOW-INCOME TENANTS BY PROHIBITING RENTAL INCREASES BASED ON TENANT FINANCIAL HARDSHIP VIOLATE THE POLICY BEHIND THE FIFTH AND FOURTEENTH AMENDMENTS.

In the words of Justice Mosk dissenting in *Pennell v. City of San Jose*, 42 Cal. 3d 365 (1986)

> "[S]atisfying the housing needs of persons in lower economic strata is necessary, but the issue is whether that obligation can be thrust upon private property owners rather than remaining the responsibility of society as a whole through tax supported government agencies." *Id*. at 733.

The Supreme Court of California has chosen to make the private property owner a subsidizer of public housing costs in violation of the U.S. Constitution.

Based on the hardship status of a tenant one landlord will receive a significantly lower rent than another landlord in identical circumstances save the fact the latter didn't rent to a hardship tenant. This disparity which denies the former landlord a reasonable return on his property amounts to a forced subsidy in violation of the just compensation, due process, and equal protection clauses of the Fifth and Fourteenth Amendments.

JUST COMPENSATION CLAUSE

This Court has held that overly harsh regulations can constitute a taking under the just compensation clause of the Fifth and Fourteenth Amendments of the Constitution. *(Pennsylvania Coal Co. v. Mahon,* 260 U.S. 393 (1922); *Penn Central Transportation Co. v. New York,* 438 U.S. 104 (1978); *Pruneyard Shopping Center v. Robins,* 447 U.S. 74 (1980); *San Diego Gas & Electric v. San Diego,* 450 U.S. 621 (1981) (Brennan, J., dissenting).)

The underlying policy of the just compensation clause is to ensure that a private property owner is not forced to bear an inordinate share of the burden of financing public programs. As stated by Justice Holmes in *Mahon:*

> "The protection of private property in the Fifth Amendment presupposes that it is wanted for public use, but provides that it shall not be taken for such use without compensation . . . . When this seemingly absolute protection is found to be qualified by the police power, the natural tendancy of human nature is to extend the qualification more and more until

> at last private property disappears. But that cannot be accomplished in this way under the Constitution of the United States.
>
> The general rule at least is, that while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking . . . We are in danger of forgetting that a strong public desire to improve the public condition is not enough to warrant achieving the desire by a shorter cut than the constitutional way of paying for the change." at 415-416. Emphasis added.

Alleviating the financial hardships of individual low-income families is more properly a function for elected governmental bodies, not for individual property owners. Requiring a landlord to assume this responsibility inordinately burdens him and the regulation becomes confiscatory.

DUE PROCESS CLAUSE

The issue presented to this Court is not whether a governmental entity such as San Jose can enact an ordinance preventing unreasonable or excessive rental increases, but rather whether such an ordinance is reasonably calculated to and does in fact alleviate the economic and financial hardship of individual tenants.

This Court has held that the constitutional right of due process is violated when the result of the regulation is not rationally related to the general purpose of that regulation. *Nebbia v. New York*, 291 U.S. 502 (1934).

While a stated purpose of the particular ordinance in question is ". . .

to alleviate undue hardship upon individual tenants" *San Jose Municipal Ordinance 19696, Section 5701.2,* the real issue is whether requiring landlords to reduce rents below the level determined as a just and reasonable rate of return is reasonably calculated to meet that purpose.

An artificial reduction in rents merely disguises the greater problem of poverty and inadequate low-income housing at the expense of the individual landlord. In fact, the ordinance may create an even more invidious problem, that of discrimination against low-income tenants. It is not difficult to construct a scenario which shows the ordinance to be counterproductive to the stated purpose.

Landlords will carefully screen tenants vis-a-vis income to ensure that they will be able to receive a just and reasonable return on their property; as a result many low-income tenants could be denied housing they might otherwise have been offered.

The California Supreme Court now has added a new factor for consideration in both the purchase and renting of residential rental units -- the financial hardship of the individual tenants inhabiting the units. Discrimination against a class of persons is an activity the California Supreme Court has stated a landlord cannot engage in when screening tenants.

> "Whether the exclusionary policy rests on the alleged undesirable propensities of those of a particular race, nationality, occupation, political affiliation, or age, in this context the Unruh Act protects individuals from such arbitrary discrimination." *Marina Point, Ltd. v. Wolfson*, 30 Cal.3d 721-726 (1982) emphasis added.

Presumably, that Court would prohibit an arbitrary policy against low-income tenants as a class of persons; yet the same Court is now stating that a landlord has a reasonable basis for establishing an exclusionary policy against that same class of people.

The very problem the ordinance purports to alleviate is in reality exacerbated by forcing the landlord to evaluate financial hardship when screening potential tenants. It is this type of law the due process clause protects against.

EQUAL PROTECTION CLAUSE

Individual property owners are protected by the equal protection clause from being forced to bear a disproportionate burden of the cost of society. Arbitrarily requiring one member of a class to pay for the cost of alleviating society's burdens while another is not required to pay is a violation of that protection.

The governing principle can be found in *Hillsborough Township v. Cromwell*, 326 U.S. 620 (1946).

> "The equal protection clause . . . protects the individual from state action which selects him out for discriminatory treatment by subjecting him to taxes not imposed on others of the same class." at 623.

When one landlord is permitted to receive a reasonable return on value while another is refused that solely because of the financial status of the tenants, the latter is treated differently in a like situtation for no rational reason. The result is a tax that violates the equal protection clause.

CONCLUSION

The California Supreme Court has created a rule of law that allows a municipality to mandate that private property owners subsidize low-income tenants. This is an issue that has a major impact on Realtors® because of the confusion in the law as it relates to rental housing.

If the California decision is left standing, the Realtor® is left with conflicting signs regarding disclosure responsibilities. According to California law, real estate licensees are required to disclose all known material facts about a property to potential purchasers, *Lingsch v. Savage*, 213 Cal.App. 2d 729 (1963). Is the Realtor® representing a buyer or seller of residential rental units required to disclose to a potential purchaser the financial background of all tenants with a warning that there may be low-income tenants in the units which could reduce the return on the property? When does the agent's fiduciary duty to disclose material facts to his or her client collide with the concept of nondiscrimination against the low-income tenant?

This Court is being asked to clarify the law as it is now in California so that Realtors®, among others in society, can pattern behavior accordingly. Providing affordable housing for low-income tenants is not only a California problem, it is a nationwide problem that requires this Court's attention and direction. If the California law is allowed to stand, it sends a signal to the rest of this country that an individual private property owner can be forced to subsidize low-income tenants.

There is no rational link either in the benefit gained or burden created which would justify imposing a societal welfare obligation as a one-on-one subsidy, rather than spreading the imposition fairly through the taxpayers as a whole.

C.A.R. urges this Court to note probable jurisdiction in this case.

DATED: December 5, 1986

Respectfully submitted,

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Counsel

By Judith K. Herzberg
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AMICUS CURIAE

BRIEF

MOTION FILED
DEC 27 1986

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No. 86-753

In The
Supreme Court of the United States
October Term, 1986

RICHARD PENNELL and TRI-COUNTY
APARTMENT HOUSE OWNERS ASSOCIATION,
Appellants,

v.

CITY OF SAN JOSE and CITY COUNCIL OF
THE CITY OF SAN JOSE,
Appellees.

**On Appeal from the Supreme Court
of the State of California**

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE AND BRIEF AMICUS CURIAE OF PACIFIC LEGAL FOUNDATION IN SUPPORT OF APPELLANTS

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On Appeal from the Supreme Court
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MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE OF PACIFIC LEGAL FOUNDATION IN SUPPORT OF APPELLANTS

This motion of Pacific Legal Foundation (PLF) to file the annexed brief amicus curiae is respectfully made pursuant to Supreme Court Rule No. 36. Consent to the filing of this brief has been granted by counsel for appellants, Richard Pennell, *et al.;* this consent has been lodged with the Clerk of this Court. Consent has been withheld by counsel for appellees, City of San Jose, *et al.*

PLF is a nonprofit, tax-exempt corporation organized and existing under and by virtue of the laws of the State of California for the purpose of engaging in litigation in matters affecting the public interest. Policy of PLF is set by a Board of Trustees composed of concerned citizens, the majority of whom are attorneys. The PLF Board evaluates the merits of any contemplated legal action and authorizes such legal action only where the Foundation's position has broad support within the general community. The PLF Board has authorized the filing of an amicus curiae brief in this matter.

Amicus firmly believes that a review of this matter is necessary in order that the constitutional issues involved may be properly considered. The decision below permitting the City of San Jose to include in its rent control ordinance unique provisions authorizing the reduction of rent increases because of the economic hardship placed on the tenant not only violates the Taking, Due Process, and Equal Protection Clauses of the Fifth and Fourteenth Amendments to the United States Constitution, but also signals to other cities and counties the availability of a new device for assisting the economically disadvantaged without expending public moneys.

PLF has participated in numerous cases which involved issues similar to those presented in this matter. The Foundation's public policy perspective and litigation experience in support of property rights and affordable housing will provide an additional viewpoint on this critical issue.

For the foregoing reasons, Pacific Legal Foundation requests that the motion to file the annexed brief amicus curiae be granted.

DATED: December , 1986.

Respectfully submitted,

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**On Appeal from the Supreme Court
of the State of California**

BRIEF AMICUS CURIAE OF PACIFIC LEGAL FOUNDATION IN SUPPORT OF APPELLANTS

INTEREST OF AMICUS

The interest of amicus is set forth in the preceding motion for leave to file this brief.

OPINION BELOW

The opinion of the California Supreme Court is reported at 42 Cal. 3d 365 (1986).

STATEMENT OF THE CASE

The California Supreme Court in its decision in *Pennell v. City of San Jose*, 42 Cal. 3d 365, approved an unprecedented city rent control ordinance imposing upon property owners the risk and burden of not enjoying a reasonable and fair return on their property should it be determined that their tenants would suffer a financial or economic hardship as a result of a rent increase. This four-to-three decision reversed the judgment of the trial court which had been affirmed in the Court of Appeal.

SUMMARY OF ARGUMENT

In the decision below the California Supreme Court ignored its own prior rulings that due process of law requires rent control ordinances to assure a fair and reasonable return to property owners and that the societal burdens of economic and financial hardships of one class, here tenants, cannot be charged to another class of society that bears no responsibility for that condition.

The ordinance results in the creation of two classes of property owners that are treated differently in regard to future rent increases: those with hardship or potentially hardship tenants and those with otherwise financially secure tenants. The latter group will be assured of receiving their full, fair, and reasonable return and the other group of landlords may not.

The ordinance further will induce discrimination against low income tenants, reducing the availability of rentals to the economically disadvantaged and thereby impinging on their constitutional right to travel.

Finally, the ordinance violates the Fifth and Fourteenth Amendments by taking private property for public use without just compensation.

ARGUMENT

I

THE SAN JOSE RENT CONTROL ORDINANCE DOES NOT ASSURE A FAIR AND REASONABLE RETURN TO PROPERTY OWNERS ON THE VALUE OF THEIR PROPERTY

The Fourteenth Amendment to the United States Constitution provides in part: "No State shall . . . deprive any person of . . . property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws." Actions taken pursuant to municipal ordinances constitute state action for purposes of the Fourteenth Amendment. *Lovell v. City of Griffin*, 303 U.S. 444, 450 (1938).

The essence of the property protected by the Constitution is the personal interest of the owner in his possessions. *Lynch v. Household Finance Corp.*, 405 U.S. 538, 552 (1972). This Court has held that a property owner

has a protected interest in the ability to use his property, *United States v. General Motors Corp.*, 323 U.S. 373, 378 (1945), which interest is given up only to a limited extent as a burden borne in exchange for " 'the advantage of living and doing business in a civilized community.' " *Andrus v. Allard*, 444 U.S. 51, 67 (1979).

In order to determine whether governmental action has deprived an individual of his property rights in violation of the Fourteenth Amendment it is necessary to examine the governmental interests and the competing private interests at stake in the case. "This examination entails inquiry into such factors as the character of the governmental action, its economic impact, and its interference with reasonable investment-backed expectations." *Pruneyard Shopping Center v. Robins*, 447 U.S. 74, 83 (1980). This determination whether government actions unconstitutionally infringe a property owner's property interests "requires an examination of whether the restriction on private property 'forc[es] some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.' " *Id.*, quoting *Armstrong v. United States*, 364 U.S. 40, 49 (1960).

Thus the courts have held that local control of rents on private property is constitutionally permissible only where the property owner or landlord is assured of receiving a fair and reasonable return on the property. *Birkenfeld v. City of Berkeley*, 17 Cal. 3d 129, 165 (1976). Any provision that permits the fixing of rents at less than a fair and reasonable rate is a confiscation of property and will invalidate an otherwise permissible rent control ordinance. *Id.*

Under the San Jose rent control ordinance at issue, however, the hearing officer "is (i) *directed* to consider the economic or financial effect of the proposed increase on the affected tenants, and is (ii) *permitted* to disallow all or part of an increase . . . if that part of the increase would impose an unreasonably severe financial or economic hardship on a particular tenant." *Pennell v. City of San Jose*, 42 Cal. 3d at 369 (emphasis in original).

The fact that the ordinance permits other adjustments which are not subject to the hardship limitation does not detract from the necessary conclusion that any property owner with a hardship tenant is subject to receiving less than the fair and reasonable return which would be granted but for the hardship status of the tenant. As Justice Mosk's dissent points out, under the ordinance the hearing officer may not authorize a landlord a higher rental increase than is due him. *Id.* at 376. Thus the only time the hardship consideration will be employed is when it serves to deny a rental increase that would otherwise be required to permit a reasonable return on his property.

Federal family income standards are to be used to determine economic hardship. All families with incomes less than 80% of the median family income for the area will qualify for hardship consideration sufficient to prevent a rent increase. The parties and the court below all agree that the number of tenants falling within this category is "potentially high." *Pennell*, 42 Cal. 3d at 369-70. From this consideration alone it is clear that the ordinance fails to provide property owners with a fair and reasonable return on the value of their property. This necessarily results in the confiscation of property in violation of the Fourteenth Amendment of the Constitution.

II

THE CITY'S RENT CONTROL ORDINANCE FACIALLY CREATES AN UNCONSTITUTIONAL CLASSIFICATION IN THAT IT FAILS TO TREAT LANDOWNERS EQUALLY SINCE LANDLORDS WITH HARDSHIP TENANTS HAVE NO ENTITLEMENT TO A FULL INCREASE IN RENT

One property owner will receive a significantly lower rental return than another in identical circumstances if the latter has the good fortune of renting to nonhardship tenants. This necessarily results in two different classifications of landlords who will receive different treatment from the rent control hearing officer. Both the rules and the process are different depending upon the existence of a hardship tenant.

The California Supreme Court had previously ruled in *Department of Mental Hygiene v. Kirchner*, 60 Cal. 2d 716 (1964), that equal protection principles prohibited the state from requiring a small class of persons—parents of adults institutionalized in state mental facilities—to pay the public expense of a patient's confinement: "A statute obviously violates the equal protection clause if it selects one particular class of persons for a species of taxation and no rational basis supports such classification." *Id.* at 722.

To withstand constitutional muster the classification based on the economic status of the tenant must not only be in furtherance of a proper social goal but in addition those not receiving the equal treatment must in some manner be responsible for or have contributed to the need for the divergent treatment. Such is clearly not the case here.

Neither the recital of the ordinance nor the rationale of the opinion below suggests that property owners with hardship tenants are responsible for their less than average incomes. Assistance for financially distressed renters is more properly an obligation of the government to be funded by general taxes and not the obligation of landlords alone.

The inescapable conclusion is that the city's failure to provide equal treatment to all landlords in considering all aspects of a requested rent increase violates the Fourteenth Amendment Equal Protection Clause.

III

THE IMPACT OF THE CITY'S RENT CONTROL ORDINANCE WILL WORK UNAVOIDABLY TO THE DETRIMENT OF, AND DISCRIMINATE AGAINST, HARDSHIP TENANTS

Justice Mosk in concluding his forceful dissent remarked on the irony that this ordinance would defeat its intended objective:

> "The tragic aspect of the provision is that it will likely prove detrimental to the very interests it seeks to protect. Landlords, who will have a great deal to lose by renting to economically marginal tenants, hereafter will carefully screen potential tenants to assure themselves of remaining entitled to a fair return on their properties. It is ironic that in upholding this unconstitutional ordinance the majority accede to a counterproductive result." *Pennell*, 42 Cal. 3d at 377.

As a direct result of the unconstitutional classification previously argued, landlords will be induced to discriminate against tenants and potential tenants who present a high risk of falling into a low income level. This

will mean that rent seekers with higher incomes and lower risk of becoming hardship tenants will have an additional advantage in competing for rental units. Discrimination and unfair economic advantage created by statute, even though not an intended result, should be invalidated where, as here, no rational basis for the disparate treatment is found. Indeed, this Court in *Shapiro v. Thompson*, 394 U.S. 618 (1969), held that statutory schemes which served to discourage low income welfare applicants from relocating impinged on their constitutional right to travel and violated the Equal Protection Clause of the Fourteenth Amendment.

IV

ON ITS FACE THE ORDINANCE ALLOWS FOR THE ARBITRARY CONFISCATION OF PROPERTY BY PERMITTING THE RENT CONTROL HEARING OFFICER TO REDUCE THE INCREASE IN RENT OTHERWISE JUSTIFIED SOLELY BECAUSE OF THE ECONOMIC HARDSHIP ON THE TENANT

Under the ordinance property owners are entitled to certain specified rent increases. If the landlord believes the formula increases are insufficient he is entitled to a hearing to determine the amount that is "reasonable under the circumstances." *Pennell*, 42 Cal. 3d at 368. The hearing officer is directed to consider and balance a number of factors including economic hardship on the tenant: "If, on balance, the Hearing Officer determines that the proposed increase constitutes an unreasonably severe financial or economic hardship on a particular tenant, he may order that the excess of the increase . . . or any portion thereof, be disallowed." Ordinance § 5703.29; *Pennell*, 42 Cal. 3d at 368 n.4. Any tenant whose family income is less than 80% of the median for the area "shall be deemed to be suffering under financial and economic hardship which *must* be weighed in the Hearing Officer's determination." *Id.* (emphasis added).

Requiring the hearing officer to balance economic hardship of the tenant against the landlord's entitlement to an increase in rent without standards is in itself unconstitutional. *Panama Refining Co. v. Ryan*, 293 U.S. 388 (1935); *Industrial Union Department v. American Petroleum Institute*, 448 U.S. 607, 675 (1980) (Rehnquist, J., concurring). Beyond that the conclusive presumption of hardship mandated by the ordinance effectively directs a reduction in any rent increases. This not only mandates the hearing officer to consider hardship but it also unconstitutionally delegates authority. Even if the tenant does not fall within the conclusively presumed hardship classification the hearing officer nonetheless is granted the authority to withhold all or part of the rent increase otherwise owing without further justification or basis. The consequence of this delegation of arbitrary authority is again the confiscation of private property for public purposes without just compensation and due process of the law as required by the Fifth and Fourteenth Amendments.

Amicus urges this Court to review the provisions of the San Jose ordinance that take away the property rights of landlords in order to assist hardship tenants.

> "It has always been a part of the judicial function to determine whether the act of one party . . . operates to devest the other party of any rights of person or property. . . . [T]he 14th Amendment . . . forbids legislation, in whatever form it may be enacted, by which the property of one individual is, without compensation, wrested from him for the benefit of another, or of the public." *Smyth v. Ames*, 169 U.S. 466, 524-25 (1898).

CONCLUSION

In upholding the San Jose rent control ordinance the California Supreme Court ignored its own prior precepts and the constitutional requirement that it provide for a fair and reasonable return to property owners. Landlords can take small satisfaction in the court's ability to review individual rate cases. Each case would be dependent upon the circumstances of each tenant and not even a large apartment complex could economically justify litigating each individual determination where constitutional barriers had been breached. The ordinance is clearly unconstitutional on its face and amicus, PLF, urges that this Court note probable jurisdiction and that the decision of the California Supreme Court affirming the ordinance be reversed.

DATED: December, 1986.

Respectfully submitted,

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AMICUS CURIAE

BRIEF

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ON APPEAL FROM THE SUPREME COURT OF THE STATE OF CALIFORNIA

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE OF THE CALIFORNIA APARTMENT ASSOCIATION IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

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Berkeley, California Ordinance No. 5261-N.S. 4

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MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE OF THE CALIFORNIA APARTMENT ASSOCIATION IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

Amicus curiae California Apartment Association respectfully moves this Court pursuant to Rule 36 of the Rules of Court for leave to file the attached brief amicus curiae in support of Appellants, Richard Pennell and Tri-County Apartment House Owners Association.

Although appellants have granted consent, appellees have withheld consent to file this breif amicus curiae.

Amicus curiae California Apartment Association is a nonprofit association which represents the interests of more than 352,000 owners of residential rental property in California, a majority of whom own four or fewer units. The interests of those individuals may be seriously jeopardized by the opinion of the California Supreme Court in this action. That opinion of a narrowly divided court permits the subjection of those interests to a confiscatory and discriminatory provision of a rent control ordinance which reduces what would otherwise be determined to be a fair and reasonable (and hence permissible) rent to accommodate the inability of any particular tenant to pay what the government would otherwise deem the fair rent.

The risk that this ruling poses to those represented by the California Apartment Association may be particularly immediate due to a common feature of many or most rent control ordinances in California cities which may arguably incorporate into those ordinances, without further amendment or formal political process, the newly approved "factor" of tenant inability to pay even the "normal" regulated rent for that unit. Those ordinances, which broadly call for the consideration of "all relevant factors" in determining the rents to be dictated in individual cases, could and likely will be interpreted by many tenant-dominated rent boards as permitting or mandating "hardship" rent reductions in individual cases, at the owner's sole uncompensated expense and due to social factors entirely unrelated to the owner, or the property, or the use thereof.

Amicus curiae California Apartment Association and its counsel are quite familiar with the issues presented by Appellants, having participated as amicus on their behalf in the California Supreme Court and being seriously concerned with the proliferation of increasingly confiscatory rent control ordinances in California. The California Apartment Association respectfully prays the court to file and consider the attached

brief amicus curiae in support of Appellants' jurisdictional statement.

Dated: December 8, 1986

Respectfully submitted,

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Telephone: (916) 447-7884

Attorneys for Amicus Curiae

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* Counsel of Record

No. 86-753

IN THE

Supreme Court of the United States

October Term, 1986

RICHARD PENNELL and
TRI-COUNTY APARTMENT HOUSE OWNERS ASSOCIATION,
Appellants,
vs.
CITY OF SAN JOSE AND CITY COUNCIL OF THE CITY OF SAN JOSE,
Appellees.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF CALIFORNIA

BRIEF AMICUS CURIAE OF THE CALIFORNIA APARTMENT ASSOCIATION IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

INTEREST OF AMICUS CURIAE

Pursuant to Supreme Court Rule 36.1, the California Apartment Association respectfully submits this brief amicus curiae in support of appellants, Richard Pennell and Tri-County Apartment House Owners Association.

Amicus curiae California Apartment Association is a nonprofit association which represents the interests of the more than 352,000 owners of residential rental property in California.

These owners, a majority of whom have their savings invested in modest holdings of four units or less, provide shelter for over 4 million households in the State of California. Over one million individual investors have their capital invested in California residential rental properties or in entities which in turn own such properties. A great many of these owners and investors have seen in recent years the imposition without state sanction of severe local rent controls which have devastated their investment-backed expectations of both profitability and marketability. As a result, the expansion of this industry—and of the housing supply and other industries related thereto—has been substantially impaired in rent-controlled California cities. Growth has also been substantially impaired in uncontrolled areas due to the reasonable fears of investors that increasing numbers of politicians will discover that the cheapest way to subsidize housing costs and thereby curry the favor of renter constituents is to exact an involuntary and uncompensated rent subsidy from the earnings of those owners and investors.

The opinion of the California Supreme Court in this action poses a new and potentially disastrous threat to those investment-backed expectations, not only in the City of San Jose but in all California jurisdictions having or contemplating rent control ordinances, thus further intensifying the deterrent to further rental housing development in the Nation's most populous state.

California Apartment Association is familiar with the issues presented in this action, having appeared as amicus curiae in support of Appellants in the California Supreme Court, and believes that its perspective presented herein as to the potential statewide effects of the opinion below may be of assistance and interest to the Court.

INTRODUCTION AND SUMMARY OF ARGUMENT

Some ten years ago the California Supreme Court upheld the validity of rent control ordinances as a valid exercise of the police power. *Birkenfeld v. City of Berkeley,* 17 Cal.3d 129 (1976). In *Birkenfeld* that court opened the door to rent controls for the stated purpose of "alleviation of the ill effects of a housing shortage by the charging of exorbitant rents." id. at 160. Now, ten years later and with rent controls firmly entrenched in many California municipalities, that court has turned that purpose on its head by upholding an ordinance which provides that a rent level or rent increase which is otherwise reasonable and certainly not "exorbitant" may nonetheless be denied an innocent owner, *not* because of the value or condition of the premises, and *not* because of any acts or omissions by the owner, but because of the economic misfortunes of the tenant which are entirely beyond the owner's control. As a result, this newly sanctioned approach to determining a "reasonable rent" and a "reasonable rate of return" necessarily reduces owner income on the basis of a criterion wholly unrelated to the owner's property or conduct, for the blatant purpose of funding a "public enterprise," the economic subsidization of the less fortunate members of our society, by exacting a subsidy without compensation from the property rights of a vulnerable minority class of citizens who are by no means uniquely responsible for the alleviation of that social problem. We submit that this constitutes a taking without compensation, a denial of due process, and a denial of equal protection.

Nor are these injuries limited to the unfortunate owners of rental properties within the reach of the instant ordinance. Rent control ordinances throughout California, where extant, typically provide that the Rent Stabilization Board or similar entity dictating rents shall consider "all relevant factors." There exists a serious concern that without any formal amendment of those ordinances, the approval below of tenant income as a proper consideration will, if sustained, spread this confiscatory perversion of "reasonable rent" formulations throughout the State of California.

ARGUMENT

I

THE FEDERAL QUESTIONS PRESENTED ARE INDEED SUBSTANTIAL

The questions Appellant has presented regarding taking private property without just compensation and discriminatory denial of equal protection are indeed substantial and important to the Nation's interests and economic health. If sustained, the confiscatory redistributive principles enunciated by the California Supreme Court as to the San Jose ordinance threaten to infect not only all other rent control ordinances in California, but additionally are applicable to any municipal determination that the providers of any goods or services should be required under the police power to dispense their products or services at or near cost to those persons whom the municipality would otherwise have to subsidize with public funds.

The opinion below (Appendix A to the Jurisdictional Statement) sanctions consideration of a tenant's ability to pay as a factor in determining a fair and reasonable rent. In so doing the California Supreme Court has, perhaps unwittingly, arguably written that factor into every rent control ordinance in the state. This is because virtually every such ordinance authorizes the municipal price-fixing entity to consider all relevant factors in the process of fixing and dictating rent levels to private citizens. For example, the City of Berkeley's ordinance which this Court subjected to antitrust scrutiny in *Fisher v. City of Berkeley*, 106 S.Ct. 1045 (1986), and which has served as a blueprint for numerous other rent control ordinances in California, provides at Section 12(c) that:

> "In making individual adjustments of the rent ceiling, the Board or the hearing examiner shall consider the purposes of this Ordinance and shall specifically consider all relevant factors, including (but not limited to): . . . ." (City of Berkeley, California, Ordinance No. 5261-N.S.)

It is entirely foreseeable that at the urging of tenants' representatives rent boards throughout California will now determine without further enactment that such typical authority to consider "all relevant factors" entitles them to reduce otherwise reasonable rents in consideration of the tenant's inability to pay a reasonable rent. As a result the income of *all* providers of California rental residences is tangibly placed at risk to municipal confiscation to subsidize those whom the city is, stated bluntly, too miserly and preoccupied with its own fiscal agenda to subsidize itself through its tax base.

Nor is there any visible limitation confining to providers of shelter this confiscatory and discriminatory shift of government's burdens. It is only the historic public bias against landlords, and the predominance of shelter costs in most family budgets, that has placed those who provide homes for others first in line to have their pockets picked. Certainly hunger in America is an even more serious and pressing police power problem than is the rental price of beachfront cottages in Santa Monica. The reasoning of the court below would permit government to scrap its enormously expensive food stamp programs and instead simply demand that food producers and retailers feed at or near cost, and without compensation, any who can produce identification showing them to be among the certified needy. Unlikely and hyperbolic as that may seem, such an arbitrary and uncompensated shift of the public burden is a logical extension of the principles fabricated below. That shift is plainly repugnant to constitutional principles heretofore enunciated by this Court. It is respectfully submitted that those principles, and the injury thereto presented by the opinion below, are unquestionably substantial and worthy of the Court's attention.

It is clear that important precedents of this Court are implicated by these issues. This court declared in ***Armstrong v. United States,*** 364 U.S. 40 (1960) that:

> "The Fifth Amendment's guarantee that private property shall not be taken for a public use without just compensation was designed to bar government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole . . . ." Id. at 49.

Can it be questioned that the above-quoted principle of ***Armstrong,*** supra, is placed at risk by the burden-shifting policy of the City of San Jose and the California Supreme Court?

By reducing rents to accommodate a public problem, poverty, which has no more unique nexus to land use than it has to the rest of the full range of human activity, the City of San Jose has crossed the line vaguely established by ***Penn Central Transportation Company v. City of New York,*** 438 U.S. 104 (1978) separating the "arbitral" functions of government from "enterprise" functions such as the performance of the government's own social welfare program responsibilities. As stated in ***Penn Central:***

> "[G]overnment actions that may be characterized as acquisitions of resources to permit or facilitate uniquely public functions have often been held to constitute 'takings'." Id. at 128.

The use of the police power to subsidize the needy is without question a "uniquely public function." This Court's declarations in ***Armstrong v. United States*** and ***Penn Central,*** supra, that such burdens may not be shifted without compensation to private parties are directly implicated and indeed offended by the result and reasoning reached below, and are needful of vindication.

Finally, the supreme courts of two states appear to be at odds on the validity of such a shift under the United States Constitution. In ***Prop. Owners Assn. etc. v. Tp. of No. Bergen,*** 74 N.J. 327, 378 A.2d 25 (1977) the New Jersey Supreme Court opined that mandating special rent reductions for a protected class of tenants, there senior citizens, was "an improper and unconstitutional method of solving the problem." 378 A.2d at 31. In the instant case, the California Supreme Court has reached the exact opposite conclusion. Certainly the import of the Fifth and Fourteenth Amendments does not vary from state to state, nor should the enforcement and protection thereof so vary. We respectfully submit that such a conflict between state court interpretations has jurisprudential implications comparable to those presented by a conflict between Circuits, and pray the Court accept and retain jurisdiction herein for that reason as well.

CONCLUSION

The California Supreme Court has held that rent control boards, once created to prevent "excessive" and "exorbitant" rents, may now reduce what would they otherwise would have had to approve as a reasonable rent for the sole reason that a tenant cannot afford to pay a reasonable rent. This not-so-subtle shift has moved the determination of "reasonable rate of return" away from factors subject to the owner's influence or related to the property itself and toward factors wholly unrelated to the owner or the property. The opinion below permits government to address systemic social problems such as poverty and unemployment by the simple expedient of delegating them involuntarily to a convenient class of victims, here the provider of housing but just as easily next the providers of food, clothing or newspapers. This shift of society's responsibilities to private individuals has been repeatedly condemned by this Court, and at least one other state's supreme court has reached the opposite conclusion under the same Constitution on functionally identical facts. It is respectfully submitted that the issues of confiscation, due process and equal protection presented by Appellants are indeed substantial, and worthy and needful of the Court's attention.

Respectfully submitted,

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* Counsel of Record

JOINT
APPENDIX

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Supreme Court, U.S.
FILED
MAY 19 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-753

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1986

RICHARD PENNELL and
TRI-COUNTY APARTMENT HOUSE OWNERS ASSOCIATION,
Appellants,

VS.

CITY OF SAN JOSE and CITY COUNCIL OF
THE CITY OF SAN JOSE,
Appellees.

**On Appeal from the Supreme Court
of the State of California**

JOINT APPENDIX

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APPEAL DOCKETED NOVEMBER 7, 1986
JURISDICTION POSTPONED MARCH 2, 1987

BOWNE OF SAN FRANCISCO, INC. • 190 NINTH ST. • S.F., CA 94103 • (415) 864-2300

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The following documents have been omitted in printing this Appendix because they appear on the following pages in the appendix to the printed Jurisdictional Statement:

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Judgment of the Superior Court, Santa Clara County, California, filed February 26, 1980	A-30
Opinion of the California Court of Appeal, filed April 25, 1984	A-17
Opinion of the California Supreme Court, filed August 11, 1986	A-1
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CHRONOLOGICAL LIST OF RELEVANT DOCKET ENTRIES

September 28, 1979—Appellants' Complaint for Declaratory and Injunctive Relief filed in the Santa Clara County, California Superior Court.

December 28, 1979—Order entered by Superior Court overruling Appellees' demurrer to Appellants' Complaint, and declaring Sections 5703.28(c)7 and 5703.29 of the Subject Ordinance unconstitutional.

December 31, 1979—Appellees' Answer to Complaint filed in the Superior Court.

February 26, 1980—Judgment entered by Superior Court declaring Sections 5703.28(c)(7) and 5703.29 of the Subject Ordinance unconstitutional.

April 16, 1980—Appellees' Notice of Appeal to the California Court of Appeal filed.

April 29, 1980—Appellants' notice of cross-appeal to the California Court of Appeal filed.

April 25, 1984—Opinion of the California Court of Appeal filed.

August 11, 1986—Opinion of the California Supreme Court filed.

October 29, 1986—Appellants' notice of appeal to the United States Supreme Court filed.

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Attorneys for Plaintiffs

Superior Court of California, County of Santa Clara

No. 435458

Complaint for Declaratory and Injunctive Relief Challenging the Constitutionality of the San Jose Rental Dispute Mediation and Arbitration Ordinance

Richard Pennell, Tri-County Apartment House
Owners Association,
Plaintiffs,

vs.

City of San Jose, City Council of the City of San Jose, and
Does One through One Hundred, inclusive,
Defendants.

[Filed September 28, 1979]

Plaintiffs allege as follows:

I.

In August of 1979, the City Council of the City of San Jose approved and adopted an ordinance entitled "San Jose Rental Dispute Mediation and Arbitration Ordinance." A copy of said ordinance is attached hereto as Exhibit "A" and incorporated herein as though fully set forth. Said ordinance adds Chapter 7 and Sections 5701.1 through 5706.5 and 2249.100 through 2249.101 to the San Jose Municipal Code. All section references as used herein refer to said code unless otherwise indicated.

II.

Plaintiff RICHARD PENNELL is an owner and lessor of 109 rental units in the City of San Jose. Plaintiff TRI-COUNTY

APARTMENT HOUSE OWNERS ASSOCIATION is an unincorporated association organized for the purpose of representing the interests of the owners and lessors of real property located in the City of San Jose. The real property owned by plaintiff RICHARD PENNELL and by the members of the TRI-COUNTY APARTMENT HOUSE OWNERS ASSOCIATION are subject to the terms of the San Jose Rental Dispute Mediation and Arbitration Ordinance.

III.

Plaintiffs do not know the true names or capacities of defendants sued herein as DOES ONE through ONE HUNDRED, inclusive, and therefore sue said defendants under the provisions of the Code of Civil Procedure, Section 474. When the same are ascertained, plaintiffs will amend this complaint to insert their true names and capacities, together with appropriate charging allegations.

IV.

Said ordinance provides a procedure for the establishment of rents and for the allowance of rental increases through arbitration proceedings. Section 5703.28 of the ordinance sets forth standards of reasonableness to be applied for the allowance by hearing officers and arbitrators for rental increases. Subsection (c) of Section 5703.28 sets forth the standards applicable for the allowance of rental increases by hearing officers when said increases exceed specified percentage increases. Subsection (7) of Subsection (c) of Section 5703.28 and Section 5703.29 provide that the economic hardship to a tenant is a relevant factor to consider and provide:

> "(7) the hardship to a tenant, as provided in Section 5703.29.
>
> "5703.29 HARDSHIP TO TENANTS. In the case of a rent increase or any portion thereof which exceeds the standards set in Section 5703.28(a) or (b), then with respect to such excess and whether or not to allow same to be part of the increase allowed under this Chapter, the Hearing Officer

> shall consider the economic and financial hardship imposed on the present tenant or tenants of the unit or units to which such increases apply. If, on balance, the Hearing Officer determines that the proposed increase constitutes an unreasonably severe financial or economic hardship on a particular tenant, he may order that the excess of the increase which is subject to consideration under subparagraph (c) of Section 5703.28, or any portion thereof, be disallowed. Any tenant whose household income and monthly housing expense meets the criteria established by the Housing Assistance Payments Program under Section 8, existing housing provisions of the Housing and Community Development Act of 1974 (P.L. 93-383) and the regulations pertaining thereto, shall be deemed to be suffering under financial and economic hardship which must be weighed in the Hearing Officer's determination. The burden of proof in establishing any other economic hardship shall be on the tenant."

V.

Sections 5704.1 and 5704.2 provide for the levy of a fee to finance the establishment and administration of the rental dispute mediation arbitration hearing process pursuant to said ordinance and state:

> "5704.1 FEES. The costs of providing and administering the San Jose Rental Dispute Mediation and Arbitration Hearing Process shall be reimbursed to the General Fund by imposition of a fee chargeable against each rental unit in the City of San Jose subject to the provisions of this Chapter.
>
> "5704.2 AMOUNT OF FEE. There is hereby imposed on each rental unit, subject to the provisions of this Chapter, a fee of three dollars and seventy-five cents ($3.75) per year which shall be paid annually at the time at which the landlord's business license fee under Article VI or Article XII of this Code is due. Said fee is includable as a cost of maintenance and operation under the definition contained in Section 5702.4. The City Manager and the Commission shall report to the Council in time for budget hearings each year their recommendation as to the amount of such fee necessary to recover the costs of the Hearing Process."

VI.

An actual and existing controversy and dispute has arisen and now exists between the plaintiffs on the one hand and the defendants on the other with respect to the validity of the ordinance and in particular the above-quoted sections in that plaintiffs contend that the ordinance and said provisions are unconstitutional, illegal and void for the following reasons:

A. Sections 5703.28(c)(7) and 5703.29, by providing that the hardship to a tenant should be considered as a factor in allowing rental increase, is unconstitutional because it obligates private individuals to assume public burdens without just compensation and is thereby a taking in violation of the Fifth and Fourteenth Amendments to the United States Constitution and the analogous provisions of the Constitution of the State of California; and

B. The ordinance, and in particular Sections 5704.1 and 5704.2 are unconstitutional in that they conflict with and violate Section 4, Article XIIIA of the State Constitution which prohibits the imposition of special taxes without the vote of two-thirds of the qualified electors of the city.

VII.

Plaintiffs are informed and believe and allege thereon that the defendants and each of them dispute each of plaintiffs' contentions and contend that the ordinance and each of the provisions thereof is constitutional, legal and valid.

VIII.

Plaintiffs seek and desire a judicial declaration of their rights and duties with respect to the San Jose Rental Dispute Mediation Ordinance declaring that said ordinance, and in particular Sections 5703.28(c)(7), 5703.29, 5704.1 and 5704.2, are facially unconstitutional, illegal and void.

IX.

Such a declaration is necessary and urgent at this time as the plaintiffs have no adequate remedy at law.

X.

Plaintiffs are informed and believe and allege thereon that the City of San Jose is in the process of implementing said ordinance and will enforce the rent setting provisions thereof including the consideration of the economic hardship of the tenants pursuant to Section 5703.28(c)(7) and will levy and impose a $3.75 per rental unit tax on the plaintiffs to finance the implementation of said ordinance. If the City of San Jose is not restrained and enjoined from doing so, plaintiffs will be faced with severe and irreparable injury from a multiplicity of civil and criminal actions for failure to comply with the ordinance.

XI.

Plaintiffs have no adequate remedy at law to prevent the injuries threatened by the City's enforcement of the ordinance and are informed and believe and allege thereon that it will face serious and irreparable injury if preliminary injunction is not issued restraining the City's implementation and enforcement of the ordinance pending judgment in this case.

XII.

Plaintiffs are informed and believe and allege thereon that their successful prosecution of this action will benefit a large class of persons, that the necessity of private enforcement makes an award of attorneys' fees appropriate and that such attorneys' fees cannot be paid out of any judgment to be obtained in this case, and consequently, if plaintiffs successfully prosecute this action, they will be entitled to the award of reasonable attorneys' fees under Section 1021.5 of the Code of Civil Procedure to be determined by post-trial motion pursuant to said section.

WHEREFORE, plaintiffs pray for judgment as follows:

1. For judgment declaring that the San Jose Rental Dispute Mediation and Arbitration Ordinance, and in particular Sections 5703.28(c)(7), 5703.29, 5704.1 and 4704.2 are facially unconstitutional and therefore are illegal and void.

2. For a preliminary and permanent injunction restraining the City of San Jose, its officers, agents and employees from taking any action to implement and enforce said ordinance or to impose or attempt to impose or collect the fees set forth in Sections 5704.1 and 5704.2 of said ordinance.

3. For reasonable attorneys' fees allowable pursuant to Section 1021.5 of the California Code of Civil Procedure.

4. For costs of suit.

5. For such other and further relief as the court deems just.

Dated: September 27, 1979.

MILLER, STARR & REGALIA

By BURCH FITZPATRICK
Burch Fitzpatrick

VERIFICATION

I, BURCH FITZPATRICK, say:

I am the attorney for the plaintiffs in this action; plaintiffs are absent from the County of Alameda, California, where I have my office, and I make this verification for and on behalf of that party for that reason; I have read the above document and know its contents; I am informed and believe and on that ground, allege that the matters stated in it are true.

Executed on September 27, 1979, at Oakland, California.

I declare under penalty of perjury that the above is true and correct.

BURCH FITZPATRICK
Burch Fitzpatrick

Exhibit "A" to complaint, the Subject Ordinance, appears as Appendix E to Appellants' Jurisdictional Statement.

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Robert R. Cimino, Deputy City Attorney
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Telephone: (403) 277-4454

Attorneys for Defendants

Superior Court of California, County of Santa Clara

Case No. 435458
Answer to Complaint

Richard Pennell, Tri-County
Apartment House Owners Association,
Plaintiffs,

vs.

City of San Jose, City Council of the City of San Jose, and
Does One through One Hundred, inclusive,
Defendants.

[Filed December 31, 1979]

Defendants CITY OF SAN JOSE and CITY COUNCIL OF THE CITY OF SAN JOSE answer the Complaint on file herein as follows:

1. Answering the allegations in paragraph I of the Complaint herein, Defendants admit the allegations contained therein.

2. Answering the allegations of paragraph II, of the Complaint, Defendants allege that they have no information or belief on the subject sufficient to enable them to answer said allegations, and placing their denial on that ground, deny each and every allegation contained therein.

3. Answering the allegations in paragraph III, Defendants allege that they have no information or belief on the subject sufficient to enable them to answer said allegations, and placing their denial on that ground, deny each and every allegation contained therein.

4. Answering the allegations of paragraphs IV and V of the Complaint, Defendants allege that the provisions of the Ordinance speak for themselves.

5. Answering the allegations of paragraph VI of the Complaint, Defendants allege that there is an actual and existing controversy and dispute which has arisen and now exits between the Plaintiffs on the one hand and the Defendants on the other, with respect to the validity of the Ordinance in that Defendants contend that the Ordinance is constitutional, legal, and valid, and a proper exercise of the powers of a chartered city. Defendants deny that any of the provisions are invalid or unconstitutional for the reasons alleged by plaintiffs or for any reason or reasons whatsoever. Answering the allegations of Subparagraph (A), Defendants deny each and every allegation contained therein. In response to the allegations of Subparagraph (B), Defendants allege that the reason asserted for the invalidity of the said provisions of the Ordinance has been found by this Court on demurrer to be insufficient as a basis for a cause of action. The demurrer was sustained without leave to amend, and therefore, Defendants refrain from answering Subparagraph (B) of paragraph VI.

6. Answering the allegations of paragraph VII, Defendants admit said allegations.

7. Answering the allegations of paragraph VIII, Defendants allege that have no information or belief on the subject sufficient to enable them to answer said allegations, and placing their denial on that ground, deny each and every allegation contained therein. Defendants further allege that Defendants seek and desire a judicial declaration of the constitutionality, legality, and validity of Sections 5703.28(c)(7) and 5703.29.

8. Answering the allegations of paragraph IX, Defendants allege that they have no information or belief on the subject sufficient to enable them to answer the allegations contained in said paragraph, and placing their denial on that ground, deny each and every allegation contained therein.

9. Answering the allegations of paragraph X, Defendants allege that they have no information or belief on the subject sufficient to enable them to answer said allegations, and placing their denial on that ground, deny each and every allegation contained therein.

10. Answering the allegations of paragraph XI, Defendants deny each and every allegation contained therein.

11. Answering the allegations of paragraph XII, Defendants deny each and every allegation contained therein, and deny that Plaintiffs are entitled to any attorneys' fees whatsoever.

WHEREFORE, Defendants pray judgment as follows:

1. For a judgment declaring that Sections 5703.28(c)(7) and 5703.29 are constitutional, legal, and valid provisions of a valid City Ordinance;
2. Denying the Plaintiffs any relief;
3. For reasonable costs; and
4. For such other relief as the Court deems just.

DATED: December 27, 1979

ROBERT J. LOGAN
City Attorney

ROBERT R. CIMINO
Deputy City Attorney

By A. C. BENNETTI
Anthony C. Bennetti
Deputy City Attorney
Attorneys for Defendants

PROOF OF SERVICE BY MAIL

NO. 435458

I, the undersigned, say:

I am a citizen of the United States, over 18 years of age, a resident of Santa Clara County, and not a party to the within action. My business address is 151 W. Mission Street, San Jose, California 95110.

On December 27, 1979, I served the within

ANSWER TO COMPLAINT

on the parties in said action, by placing a true copy thereof enclosed in a sealed envelope with postage thereon fully prepaid, in the United States mail at San Jose, California, addressed as follows:

BURCH FITZPATRICK, ESQ.
Miller, Starr & Regalia
One Kaiser Plaza, Suite 1650
Oakland, CA 94612

I declare under penalty of perjury that the foregoing is true and correct.

Executed at San Jose, California, on December 27, 1979.

Valerie A. Franco

Supreme Court of the United States
Office of the Clerk
Washington, D.C. 20543

March 2, 1987

Mr. Burch Fitzpatrick
Miller, Starr & Regalia
101 California St., Suite 2200
San Francisco, CA 94111

Re: Richard Pennell and Tri-County Apartment House
Owners Association,
v. City of San Jose and City Council of San Jose
No. 86-753

Dear Mr. Fitzpatrick:

The Court today entered the following order in the above entitled case:

The motion of California Association of Realtors for leave to file a brief as amicus curiae is granted. The motion of Pacific Legal Foundation for leave to file a brief as amicus curiae is granted. The motion of California Apartment Association for leave to file a brief as amicus curiae is granted. Further consideration of the question of jurisdiction is postponed to the hearing of the case on the merits.

Very truly yours,

Joseph F. Spaniol, Jr., Clerk

APPELLANT'S BRIEF

Supreme Court, U.S.
FILED
MAY 19 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-753

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1986

RICHARD PENNELL and
TRI-COUNTY APARTMENT HOUSE OWNERS ASSOCIATION,
Appellants,

VS.

CITY OF SAN JOSE and CITY COUNCIL OF
THE CITY OF SAN JOSE,
Appellees.

**On Appeal from the Supreme Court
of the State of California**

BRIEF OF APPELLANTS

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* *Counsel of Record*

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BEST AVAILABLE COPY

QUESTION PRESENTED FOR REVIEW

Are municipal rent regulations that compel individual property owners to subsidize the welfare of low income tenants by prohibiting rental increases because of an individual tenant's economic hardship repugnant to the due process, equal protection or just compensation clauses of the Fifth and Fourteenth Amendments?

PARTIES TO THIS APPEAL

The parties in this case are Appellants, Richard Pennell and Tri-County Apartment House Owners Association, who were plaintiffs, respondents and cross-appellants in the lower courts and Appellees, City of San Jose and City Council of the City of San Jose, who were defendants, appellants and cross-respondents in the lower courts.

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No. 86-753

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1986

RICHARD PENNELL and
TRI-COUNTY APARTMENT HOUSE OWNERS ASSOCIATION,
Appellants,

VS.

CITY OF SAN JOSE and CITY COUNCIL OF
THE CITY OF SAN JOSE,
Appellees.

On Appeal from the Supreme Court
of the State of California

BRIEF OF APPELLANTS

OPINIONS BELOW

The opinion of the California Supreme Court is cited as *Richard Pennell, et al. v. City of San Jose*, 42 Cal. 3d 365, 228 Cal. Rptr. 726, 721 P. 2d 1111 (1986), and appears as Appendix A to Appellants' Jurisdictional Statement. The opinion of the California Court of Appeal was cited (until vacated) as *Richard Pennell, et al. v. City of San Jose*, 154 Cal. App. 3d 1019, 210 Cal. Rptr. 728 (1984), and appears as Appendix B to Appellants' Jurisdictional Statement. The judgment of the California Superior Court appears as Appendix C to Appellants' Jurisdictional Statement.

JURISDICTIONAL BASIS

The California Supreme Court filed its opinion in this case on August 11, 1986, reversing the judgment for Appellants in the Superior Court that had been affirmed by the California Court of Appeal. Appellants filed a Notice of Appeal to this Court on October 29, 1986.[1] This Court has jurisdiction of this appeal under 28 U.S.C. Section 1257(2), which provides for an appeal from a final judgment of a state's highest court "where is drawn in question the validity of a statute of any state on the ground of its being repugnant to the Constitution . . . and the decision is in favor of its validity." Section 1257(2) applies where a municipal ordinance has been declared constitutional by a state's highest court. *Erznoznik v. City of Jacksonville*, 422 U.S. 205, 207 n. 3 (1975). On March 2, 1987 the court entered an order postponing consideration of the question of jurisdiction to hearing of the case on the merits.

RELEVANT CONSTITUTIONAL AND STATUTORY PROVISIONS

The relevant Constitutional provisions involved in this appeal are:

Fifth Amendment, Section 1:

> No person shall be . . . deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

Fourteenth Amendment, Section 1:

> No State shall . . . deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

The relevant statutory provisions involved in this appeal are:

The San Jose Rental Dispute Mediation and Arbitration Ordinance, San Jose Municipal Ordinance 19696 (the "Subject Ordinance"), which appears as Appendix E to Appellants' Jurisdictional Statement. The pertinent portions of the Subject Ordinance are:

> § 5703.28(c): When the amount of any rent increase or portion thereof exceeds any of the foregoing standards under subsections (a) or (b) of this Section, the Hearing Officer shall determine what is reasonable under the circumstances taking into account any of the following factors on which he has received information:
>
> > (1) In the case of increased costs of debt service due to a sale or refinancing of the rental units or the building or property of which the units are a part within twelve (12) months of the increase: (i) the arms length nature of the transaction, (ii) the landlord's rate of return on the investment, (iii) the frequency of past resale or refinances, and (iv) the extent to which prior rental increases have made provisions for appreciation of asset value;
> >
> > (2) the rental history of the unit or the complex of which it is a part, including: (i) the presence or absence of past increases, (ii) the frequency of past rent increases, (iii) the landlord's response to Proposition 13 savings, and (iv) the occupancy rate of the complex in comparison to comparable units in the same general area;
> >
> > (3) the physical condition of the rental unit or complex of which it is a part, including the quantity and quality of maintenance and repairs performed during the last twelve (12) months;
> >
> > (4) any increases or reductions of housing services since the last rental increase before the effective date of this Ordinance.
> >
> > (5) other financial information which the landlord is willing to provide;
> >
> > (6) existing market value of rents for units similarly situated;

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[1] A copy of the Notice of Appeal appears as Appendix D to Appellants' Jurisdictional Statement.

> (7) the hardship to a tenant, as provided in Section 5703.29.
>
> § 5703.29: . . . [T]he Hearing Officer shall consider the economic and financial hardship imposed on the present tenant or tenants . . . . Any tenant whose household income and monthly housing expense meets the criteria established by the Housing Assistance Payments Program under Section 8, existing housing provisions of the Housing and Community Development Act of 1974 (P.L. 93-383) and the regulations pertaining thereto, shall be deemed to be suffering under financial and economic hardship which must be weighed in the Hearing Officer's determination.

STATEMENT OF THE CASE

The City Council of the City of San Jose adopted San Jose Municipal Ordinance 19696, entitled the "San Jose Rental Dispute Mediation and Arbitration Ordinance" (the "Subject Ordinance") on July 10, 1979. The stated purpose of the Subject Ordinance is:

> to alleviate some of the more immediate needs created by San Jose's housing situation. These needs include but are not limited to prevention of excessive and unreasonable rent increases, the alleviation of undue hardship upon individual tenants, and the assurance to landlords of a fair and reasonable return on the value of their property.

Section 5701.2.[2]

The Subject Ordinance establishes a mechanism under which tenants can challenge the reasonableness of rental increases that exceed, in any twelve-month period, the greater of 8% or the amount of certain specified cost or debt service pass throughs. Section 5703.28(c) lists seven factors for consideration by hearing officers in the determination of the reasonableness of challenged rental increases. The first five factors involve the income, expenses and condition of the rental property involved, and the sixth is market value of comparable rents. The seventh is the economic or financial hardship of the tenant or tenants of the rental unit or units involved. Tenants qualifying under the criteria established by the Housing Assistance Payments Program under Section 8 of the Housing and Community Development Act of 1974 (P.L. 93-383) are deemed *automatically* to be suffering under financial and economic hardship which *must* be weighed in the hearing process.[3]

Appellants, who are owners and operators of residential rental properties in San Jose, filed their Complaint in this action on September 29, 1979 in Santa Clara County Superior Court, alleging that Sections 5703.28(c)(7) and 5703.29 of the Subject Ordinance violate the Fifth and Fourteenth Amendments of the United States Constitution because they obligate private individuals to assume the public burden of subsidizing low income tenants without just compensation.[4] On February 26, 1980, the Superior Court entered a judgment on the pleadings in favor of Appellants, declaring Sections 5703.28(c)(7) and 5703.29 unconstitutional and enjoining their enforcement.[5] The California Court of Appeal affirmed the Superior Court judgment on April 25, 1984.[6] On July

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[2] Unless otherwise specified, all references to "Sections" are to the Subject Ordinance, which appears as Appendix E to Appellants' Jurisdictional Statement.

[3] Section 8 of the Housing and Community Development Act of 1974 generally provides that families whose income is less than 80% of the median family income in an area qualify for assistance. 24 C.F.R. §§ 880.201, 882.102.

[4] Appellants' Complaint, which appears at page 2 of the Joint Appendix, also sought to invalidate fees imposed on rental units under the Subject Ordinance as violative of Section 4 of Article XIIIA of the California Constitution. The Superior Court dismissed this portion of Appellants' Complaint, which dismissal has been affirmed by the Court of Appeal and the California Supreme Court. That portion of the judgment below is not being appealed.

[5] A copy of the judgment of the Superior Court appears as Appendix C to Appellants' Jurisdictional Statement.

[6] A copy of the opinion of the Court of Appeal appears as Appendix B to Appellants' Jurisdictional Statement.

26, 1984, the California Supreme Court granted Appellee's petition for a hearing to review the Court of Appeal decision. On August 11, 1986, the California Supreme Court reversed the judgment and held Sections 5703.28(c)(7) and 5703.29 of the Subject Ordinance to be constitutional.

SUMMARY OF ARGUMENT

The tenant hardship provisions of the Subject Ordinance are facially unconstitutional because whenever applied the result will be confiscatory. Due process requires that rent regulations be reasonably calculated to eliminate excessive rents and provide landlords with a just and reasonable return on their property. The individual financial hardship of a tenant has no bearing on the rental value of the unit he occupies. Moreover, a single tenant's financial condition is not sufficiently representative of the tenant population of San Jose to be considered in the administrative balancing process to establish what rate of return on the value of rental units is just and reasonable. Because individual tenant hardship has no rational relationship to either the reasonableness of requested rental increases or the reasonableness of the return afforded by such increases, any disallowance or limitation of rental increases resulting from application of the tenant hardship provisions will deprive a landlord of a just and reasonable return on the value of his property.[7]

By limiting rental increases based upon an individual tenant's financial hardship, the Subject Ordinance shifts the public burden of subsidizing housing needs of low income tenants onto individual landlords. There is no rational link, either in the benefit gained by such landlords or the burdens they create, which justifies imposing that welfare obligation on them as a one-on-one subsidy. The subsidy imposed is a species of taxation and selection of one particular class of persons for a species of taxation without rational basis violates the equal protection clause. The burden

imposed by the tenant hardship provisions on individual landlords, rather than on the class of landlords generally or on taxpayers as a whole, is far less rational than the support obligations imposed on parents and children of incarcerated persons under the responsible relative reimbursement legislation that has been invalidated by the California Supreme Court as a violation of equal protection.

The just compensation clause of the Fifth Amendment was designed to prevent government from imposing on some people burdens that in fairness should be borne by the public as a whole. The Subject Ordinance does not regulate the physical use and development of land, so the disallowance of rental increases need not deprive landlords of all or substantially all reasonable use of their property, as required in land use cases, to warrant protection under the just compensation clause. The Subject Ordinance prohibits eviction of low income tenants, and is therefore analogous to the physical taking and occupation cases, which require compensation even for minor deprivations in value. Since the Subject Ordinance provides no compensation to landlords who are compelled by it to subsidize the hardship of their tenants, any application of the tenant hardship provisions constitutes a taking without just compensation and is invalid under the Fifth Amendment.

I

JURISDICTION SHOULD BE NOTED BECAUSE THIS APPEAL PRESENTS A SUBSTANTIAL FEDERAL QUESTION RIPE FOR REVIEW

A. The question presented herein impacts all rent regulation and price control in general

In *Birkenfeld v. City of Berkeley*, 17 Cal.3d 129, 130 Cal. Rptr. 465, 550 P.2d 1001 (1976), the California Supreme Court held rent control legislation to be a valid exercise of the police power as a rational curative measure for the concomitant ill effects of a housing shortage if "reasonably calculated to eliminate excessive rents and at the same time provid[ing] landlords with a just and reasonable rate of return on their property." *Id.* at 160, 165, 135 Cal. Rptr. 465, 491, 550 P.2d 1001, 1027. However, that court struck down the rent regulations under consideration as confiscatory and facially unconstitutional because they lacked a sufficient adjustment mechanism necessary to allow landlords a just and reasonable return on their property.

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[7] Application of the tenant hardship provisions would also be confiscatory if the ordinance used a return on investment standard rather than value standard because an individual tenant's financial hardship also has no bearing on a landlord's investment in his property.

The subject ordinance contains an adjustment mechanism to permit landlords to increase rents sufficiently to receive a just and reasonable return on their property when the flat rate and cost pass through increases contained in Section 5703.28(a) and (b) are insufficient. The operation of the adjustment mechanism and the landlords' ability to increase rents sufficiently to receive a just and reasonable return are, however, limited by the tenant hardship provisions contained in Section 5703.28(c)(7) and 5703.29 of the Subject Ordinance. The tenant hardship sections require hearing officers to consider and weigh an individual tenant's economic and financial hardship in determining the reasonableness of such rental increases, even though such hardship has no bearing on the rental value of the unit that tenant occupies. By approving application of the tenant hardship provisions of Sections 5703.28(c) and 5703.29, the California Supreme Court has taken a giant step beyond approving municipal rent regulation as a curative measure to eliminate excess rents. Application of the hardship provisions to deny a landowner a just and reasonable return is repugnant to the due process, equal protection and just compensation clauses of the Fifth and Fourteenth Amendments of the Constitution because it shifts the burden of providing financial assistance to poor renters from the public at large to individual property owners.

If allowed to stand, the decision of the California Supreme Court in this case will have a substantial impact on all municipal rent legislation. Municipal rent regulation normally imposes rent ceilings that are subject to adjustment to assure individual landlords a constitutionally required just and reasonable return on their property. That adjustment procedure necessitates evidentiary hearings on the reasonableness of rents and the return afforded individual landlords. The factors considered at such hearings normally include objective factors such as the physical condition, operating costs and rental history of the subject property, the landlord's investment in or the comparable rental values of, the subject property, and a catchall for other "relevant factors" bearing on the reasonableness of rents. If the California Supreme Court decision in this case is allowed to stand, then cities across the nation can be expected to shift a portion of their public welfare obligation to private landlords by including individual tenant hardship as a consideration in determining the reasonableness of rents and the return afforded landlords.

Moreover, if the reasonableness of the price for housing services under municipal rent regulations can be based on the financial needs of the user of such services, it follows that the price for any goods or services can also be based on the financial needs of an individual consumer under any price control scheme. The rationale of the decision appealed herein is not limited to rent and price controls, because it is predicated on the implicit assumption that cities can use their police power to exact resources from private citizens to finance purely governmental functions without regard to benefit and burdens involved in the regulated activity.

B. The question presented is ripe for review because any application of the tenant hardship standard to reduce rents is confiscatory

The tenant hardship provisions of the subject ordinance come into play whenever a rental increase exceeds the flat 8% per annum or the cost pass through increases permitted under Section 5703.28(a) and (b) of the Subject Ordinance.[8] Either a landlord or a single tenant may petition for review of the reasonableness of such increases. Sections 5703.6 and 5703.7.[9] Section 5703.28(c) directs hearing officers to consider the reasonableness of such rents that exceed these standards by considering objective factors relating to the rental unit involved, including debt service, rental history, physical condition, increases in or reductions of housing services, other relevant financial information and comparable market rents. The hearing officer is then directed under Section 5703.29 to consider the economic financial hardship imposed on the present tenant or tenants of the unit involved. A tenant whose household income and monthly housing expense meets the criteria of the housing assistant payments program under Section 8, existing housing provisions of the Housing Community Act 1974 (P.L. 93-383) and the regulations pertaining thereto, is deemed to be suffering under financial economic hardship which *must* be weighed in the hearing officer's determination of reasonableness.

---

[8] Characterization of the 8% per annum flat rate increase automatically allowed by Section 5703.28(a) as "generous" is misleading. See *Pennell v. City of San Jose, supra*, 42 Cal.3d 373, 374 and Appellees' motion to dismiss or affirm, page 3. Although an 8% per annum increase may be generous to landlords already charging market rents, it can be grossly insufficient to landlords with rents substantially below market for whom the adjustment mechanism is constitutionally required. Ironically, the economic burden incident to rent regulations implemented by the imposition of across-the-board rent ceilings falls most heavily on those landlords who have been the most *generous* to tenants by charging low rents.

Rent regulations are facially invalid if they will not permit those who administer the ordinance to avoid confiscatory results. *Fisher v. City of Berkeley*, 37 Cal.3d 644, 679, 209 Cal. Rptr. 682, 710, 711, 693 P.2d 261 290 (1984), *Aff'd.* 471 U.S. 1124 (1985) and 475 U.S. 260 (1986)[10]; *Birkenfeld v. City of Berkeley*, 17 Cal.3d 129, 165, 130 Cal.Rptr. 465, 491, 550 P.2d 1001, 1027, (1976); *Cotati Alliance for Better Housing v. City of Cotati* 148 Cal. App.3d 280, 287, 195 Cal. Rptr. 825, 829 (1983); and *Hutton Park Gardens v. Town Council*, 68 N.J. 543, 568-572, 350 A.2d 1, 14-16 (1975). Giving meaningful weight to the tenant hardship factors necessarily results in depriving landlords of what the hearing officer would otherwise objectively calculate as a reasonable return, based on the particular rental history of the unit, its condition, housing services provided, financial information such as debt service, and the existing market for comparable rents under under Section 5703.28 Subd. (c)(1)-(6). Accordingly, the tenant hardship provisions are confiscatory and facially invalid because, whenever applied, they will operate to deprive landlords of a just and reasonable return on their property."[11]

II

THE TENANT HARDSHIP PROVISIONS VIOLATE DUE PROCESS BECAUSE THEY COMPEL A ONE-ON-ONE SUBSIDY THAT IS ARBITRARY, DISCRIMINATORY AND DEMONSTRABLY IRRELEVANT TO PERMISSIBLE LEGISLATIVE POLICY

A. The tenant hardship provisions are not calculated to eliminate excess rents, and operate to deny landlords a just and reasonable return on their property

In *Birkenfeld v. City of Berkeley*, 17 Cal. 3d 129, 130 Cal. Rptr. 465, 550 P.2d 1001 (1976), the California Supreme Court held:

> The provisions [of the legislation under review] are within the police power if they are reasonably calculated to eliminate excessive rents and at the same time provide landlords with a just and reasonable return on their property. However,

---

[9] The landlord cannot always control triggering this review because "rent increases" include broadly defined reductions in "housing services." Sections 5702.8 and 5202.11.

[10] The appeal of *Fisher v. City of Berkeley* was dismissed for want of substantial federal question but probable jurisdiction was noted on the antitrust issues. *Fisher v. City of Berkeley, supra*, 471 U.S. 1124. The decision was later affirmed on the antitrust issues. *Fisher v. City of Berkeley*, 475 U.S. 260 (1986).

[11] The California Supreme Court noted that it would consider the disparity of approved rents among landlords only upon a challenge to the ordinance *as applied* to a particular landlord and a particular tenant. *Pennell v. City of San Jose, supra*, 42 Cal. 3d 365, 374. In utility rate cases, the United States Supreme Court has held that whether a regulation of prices is reasonable or confiscatory depends upon the result reached, not the method used to reach that result. *Power Comm'n. v. Hope Gas Co.*, 320 U.S. 591, 602 (1944). However, such rate cases involving huge sums of money and prosecuted by large utility companies are not analogous to review of the small amounts involved in individual landlord-tenant disputes. Requiring a review of the tenant hardship provisions of the Subject Ordinance *as applied* to a particular landlord and tenant guarantees that no judicial review will take place, because the cost of bringing such a case just to the Superior Court is vastly disproportionate to the amount of the lost rental income involved.

> if it is apparent from the face of the provisions that their effect will necessarily be to lower rent more than could reasonably be considered to be required for the measure's stated purpose, they are unconstitutionally confiscatory.

Id. at 165, 130 Cal. Rptr. at 491, 550 P.2d at 1027.

This two-part due process test requires that rent regulations be reasonably calculated to eliminate excessive rents and at the same time provide landlords with a reasonable return on their property. The tenant hardship provisions of the Subject Ordinance fail both parts of that test.

Proposed rental increases that are reviewed under the ordinance are evaluated against the seven standards contained in Section 5703.28(c). The first six standards are objective, encompassing the debt service, rental history, physical condition, changes in housing services, operating expenses and comparable rental value of the unit involved. Application of these six standards determines the reasonable rental value of the unit involved, which by definition cannot be excessive. The rental value of an apartment is no more dependent on the wealth or lack of wealth of its occupant than the value of an automobile is dependent upon the wealth or lack of wealth of its owner or driver. Accordingly, application of the seventh standard, tenant hardship, will reduce the rent below the objectively calculated reasonable rental value of the unit involved and will not and cannot operate to eliminate *unreasonable* or *excessive* rents.

The Subject Ordinance requires hearing officers to consider the distortional effects of San Jose's overall housing shortage upon prevailing market rents in determining the reasonability of a rental increase. The determination of what rate of return on property is just and reasonable involves balancing the landlord's right to a return equivalent to investments of a similar risk, against the economic, financial and housing needs of all tenants living in San Jose. *See Power Comm'n. v. Hope Gas Co.*, 320 U.S. 591, 603 (1944) and *Hutton Park Gardens v. Town Council*, 68 N.J. 543, 569-570, 350 A.2d 1, 15 (1975). It is not rational to consider the economic and financial condition of one single tenant as representative of the economic, financial and housing needs of San Jose's entire tenant population. Accordingly, the economic and financial condition of the single tenant whose rent is being reviewed has no rational relationship to the reasonableness of the *rate* of return afforded landlords on their property, and any application of the tenant hardship provisions will necessarily deprive landlords of a just and reasonable return on that property.

Application of the tenant hardship provisions of the San Jose ordinance on an individual unit-by-unit basis also creates a prohibitive impediment to landlords obtaining a just and reasonable return on their property. The determination of such economic hardship and the severity of that hardship involves consideration of a tenant's employment status, income, assets, family responsibilities, health, employment opportunities, educational background and a vast array of other factors. Landlords do not have any reasonable means of investigating such factors and no discovery procedures are provided under the ordinance to verify the tenant's hardship claims. Even if discovery and investigation procedures were available, the cost of discovery and litigation of individual tenant hardship claims would exceed the amount of the incremental rental increases sought. Accordingly, the burden of defending against claims of tenant hardship obstructs the use of the mechanism built into the ordinance to provide landlords with a constitutionally required just and reasonable return.

B. The tenant hardship provisions of the subject ordinance serve an improper legislative purpose

Although the tenant hardship provisions do not operate to eliminate unreasonable or excessive rent increases, they do serve the stated legislative purpose of alleviating the financial and economic hardship of individual tenants. Price control is held to be "unconstitutional . . . if arbitrary, discriminatory, or demonstratively irrelevant to the policy the legislature is free to adopt." In re *Permian Basin Area Rate Cases*, 390 U.S. 747, 769-770 (1968), citing *Nebbia v. People of the State of New York*, 291 U.S. 502, 539 (1934); *see also Birkenfeld v. City of Berkeley*, 17 Cal. 3d 129, 165, 130 Cal. Rptr. 465, 491, 550 P.2d 1001, 1027 (1976). Even though the tenant hardship provisions are rationally related to one of the stated purposes of the subject ordinance, they are invalid because San Jose is not free to adopt a policy of requiring landlords to reduce otherwise reasonable rents in order to subsidize the welfare of individual hardship tenants.

After noting that it has never addressed the specific issue raised in this case, and that it was aware of no other rent control ordinance containing similar tenant hardship provisions, the California Supreme Court relied on its decisions in *Birkenfeld v. City of Berkeley, supra*, 17 Cal. 3d 129, 130 Cal. Rptr. 465, 550 P.2d 1001, *Carson Mobile Home Park Owners' Ass'n. v. City of Carson* 35 Cal. 3d 184, 197 Cal. Rptr. 284, 672 P.2d 1297 (1983) and *Fisher v. City of Berkeley*, 37 Cal. 3d 644, 209 Cal. Rptr. 682, 693 P. 2d 261 (1984), to uphold the validity of the tenant hardship provisions. The Court reasoned that it had already confirmed the propriety of placing the burden of *subsidizing* tenants on landlords to the extent of the difference between unregulated *market* rents and regulated *fair return* rents. *Pennell v. City of San Jose, supra*, 42 Cal. 3d at 372. The compelled subsidy represented by the difference between regulated *fair return* rents and *market* rents serves the only legitimate purpose of rent regulation, the elimination of unreasonable and excessive rents. That purpose is not served by the tenant hardship provisions in the Subject Ordinance, which operate to reduce rents below the *fair return* level, in order to provide an individual tenant hardship subsidy. Protection of tenants against unreasonable and excessive rent is a proper legislative purpose, one-on-one subsidization of tenant hardship by landlords is not.

The Supreme Court of New Jersey has twice stated that it is not constitutional to compel landlords to subsidize special treatment for needy senior citizens. *Property Owners Ass'n. etc. v. Township of N. Bergen*, 74 N.J. 327, 378 A.2d 25 (1977) and *Helmsley v. Borough of Fort Lee*, 78 N.J. 200, 394 A.2d 65 (1977) Addressing this issue in *North Bergen*, the New Jersey Supreme Court stated:

> We reiterate that under its police power, a municipality may in the interests of the general welfare enact ordinances to assist senior citizens provided the relationship between the purposes and the classification is rational and sound and there is not an undue taking of property of others which amounts to a constitutional confiscation. A legislative category of economically needy senior citizens is sound, proper and sustainable as a rational classification. But compelled subsidization by landlords or by tenants who happen to live in an apartment building with senior citizens is an improper and unconstitutional method of solving the problem. In view of our holding herein, we have found it unnecessary to discuss the equal protection argument adverted to us by the Appellate Division.

Id., 378 A.2d at 31.

The California Supreme Court discusses the subsidization issue in Footnote 9 to its opinion, where it distinguishes the above-quoted language from *Prop. Owners Ass'n. etc. v. Township. of N. Bergen*, as dicta. That footnote also relies on two subsequent New Jersey cases for the proposition that *Prop. Owners Ass'n. etc. v. Township. of N. Bergen*, allows for "mandated subsidization by a property owner . . . 'as long as it is not exessive.' " *Pennell v. City of San Jose, supra*, 42 Cal. 3d at 373.[12] The California Supreme Court then concludes its Footnote 9 by citing *So. Burlington County. N.A.A.C.P. v. Mt. Laurel Township* 92 N.J. 158, 456 A.2d 390, 446 n. 30 (1983) for the proposition that *North Bergen* does not invalidate municipal ordinances requiring developers to set aside a portion of a development for low income housing.

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[12] The California Supreme Court's reliance on this quote is not supported by an analysis of the New Jersey cases. The quote was excerpted from the Superior Court Appellate Division case of *In re Egg Harbor Associates*, 185 N.J. Super. 507, 523, 449 A.2d 1324, 1333-1334 (1982), aff'd. *sub nom. Matter of Egg Harbor Assoc. (Bayshore Centre)* 94 N.J. 358, 464 A.2d 1115 (1983). The appellate division in *Egg Harbor* excerpted the quoted material from *Matter of Review of Health Care Admin.*, 83 N.J. 67, 415 A.2d 1147 (1980). The quote as originally stated in *Matter of Review of Health Care Admin.*, was not part of any analysis or evaluation of *Prop. Owners' Ass'n. etc. v. Township of N. Bergen*, and was not in the nature of a ruling or holding, but rather was only a reference to a concession made in an amicus brief. *Matter of Review of Health Care Admin., supra*, 83 N.J. 67, 84, 415 A.2d 1147, 1155. In *Egg Harbor*, the New Jersey Supreme Court, in affirming the appellate division case, did *not* use this quote.

The three New Jersey cases decided after *North Bergen* are distinguishable. Both *Matter of Egg Harbor Associates*, 94 N.J. 358, 464 A.2d 1115 (1948) and *So. Burlington County N.A.A.C.P. v. Mt. Laurel Township, supra*, 92 N.J. 158, 456 A.2d 390 involved a required set-aside of a portion of a development for low or moderate income housing, which was upheld because it was "rationally related to the benefit and the burdens created by the project itself." In Re *Egg Harbor Associates, supra*, 449 A.2d at 1333. By relying on the burdens and benefits created by the projects involved, these two cases essentially affirm the determination in *North Bergen* that private individuals cannot be compelled to assume the public's welfare burden to provide for the needy.

In *Matter of Review of Health Care Admin., supra*, 83 N.J. 67, 415 A.2d 1147, the New Jersey Supreme Court affirmed a requirement that licensed nursing home facilities set aside beds for indigent patients. There, the court reasoned that nursing home facilities are quasi-public entities already subject to extensive regulation in the public interest, and that the burden imposed was properly spread among the owners of all such facilities. *Id.* at 1152-1153. San Jose's rental units are not quasi-public facilities subject to extensive regulation, and the welfare burden arising out of the tenant hardship provisions is not spread among all landlords. The need to spread the burden was a critical point of distinction for Justice Mosk, who notes in his dissent that:

> Moreover, although we have repeatedly upheld rent control ordinances that apply to landlords as a class, this measure goes a critical step further by requiring individual landlords to reduce rentals for individual tenants with financial hardship. There is no rational link, either in the benefit gained or the burden created, which would justify imposing that welfare obligation as a one-on-one subsidy, rather than spreading the imposition fairly through the class of landlords generally or taxpayers as a whole.

Pennell v. City of San Jose, supra, 42 Cal. 3d at 377

Implicit in the majority opinion is the assumption that special assistance legislation for the needy can be piggybacked onto rent control legislation as long as the mandated subsidization is not "excessive" or "grossly unfair." Reduction of rents below a reasonable level in order to subsidize the welfare needs of individual tenants is a misuse of the police power to finance the public burden of assisting the poor that cannot be justly sustained by coupling it with otherwise valid rent regulation.

C. The tenant hardship provisions constitute an arbitrary, discriminatory and unwarranted interference with personal liberty

Although the Supreme Court approved the imposition of price regulations in businesses "affected" with the public interest in the early case of *Munn v. People of Illinois*, 94 U.S. 113 (1876), and approved state and federal rent control regulations imposed during emergency conditions arising out of World War I (*Levy Leasing Co. v. Siegel*, 258 U.S. 242 (1922); *Marcus Brown Co. v. Feldman*, 256 U.S. 170 (1921); and *Block v. Hirsh*, 256 U.S. 135 (1921)), a majority of the Court then held the view that the due process clause included a freedom of contract which normally precluded either state legislatures or Congress from regulating prices not affected with the public interest. For example, the Court invalidated legislation fixing minimum wages for women in *Adkins v. Children's Hospital*, 261 U.S. 525 (1923), limiting markup of theater tickets in *Tyson & Brother v. Banton*, 273 U.S. 418 (1927), and limiting fees chargeable by employment agencies in *Ribnik v. McBride*, 277 U.S. 350 (1928). In these cases, the Court distinguished its prior rent control decisions as involving temporary statutes necessary to meet grave emergencies. *Adkins v. Children's Hospital, supra*, 261 U.S. at 551-552; *Tyson & Brother v. Banton, supra*, 273 U.S. at 437. *See also Chastleton Corp. v. Sinclair*, 264 U.S. 543, 548-549 (1924).

Repudiation of this restrictive view of the exercise of the police power was heralded in *Nebbia v. New York*, 291 U.S. 502 (1934), where the Court upheld the validity of price regulations imposed by the State of New York on its milk industry.[11] After careful analysis of *Munn v. People of Illinois, supra*, 94 U.S. 113, the

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[11] *See also Olsen v. Nebraska*, 313 U.S. 236 (1941), expressly overruling *Ribnik v. McBride*, 277 U.S. 350 (1928).

Court in *Nebbia* concluded that the term "affected with the public interest" meant no more than "subject to the exercise of the police power" and held that:

> Price control, like any other form of regulation, is unconstitutional only if arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt, and hence unnecessary and unwarranted interference with individual liberty.

Nebbia v. New York, supra, 241 U.S. at 539.

In *Nebbia*, the Supreme Court reasoned that imposition of the price regulations was a rational curative measure to avoid destructive competition and trade practices in the milk industry. In addition, it affirmed the validity of discrimination between the prices that could be charged by milk distributors and store owners based upon the difference in their costs of operation. *Id.* at 530.

In the mid-1970's, state courts began following the lead of *Nebbia v. New York*, by abandoning emergency conditions as a prerequisite for rent control legislation and upholding rent regulation as a rational curative measure to eliminate excessive rents arising out of a housing shortage. *Birkenfeld v. City of Berkeley, supra*, 17 Cal. 3d 129, 130 Cal. Rptr. 465, 550 P.2d 1001; *Hutton Park Gardens v. Town Council, supra*, 68 N.J. 543, 350 A.2d 1; and *Westchester West No. 2 Ltd. Partnership v. Montgomery County*, 276 Md. 448, 348 A.2d 856 (1975). However, the reasoning of both *Nebbia v. New York*, and *Birkenfeld v. City of Berkeley* indicate that price regulation still needs to be designed to address an identifiable threat to the public health, safety and welfare. In the case of rent regulation, that threat is the potential for unreasonable and excessive rents. Because the tenant hardship provisions of the subject ordinance are not designed to eliminate unreasonable or excessive rents, or for any other legitimate legislative purpose, they constitute an arbitrary, unwarranted and unnecessary interference with personal liberty in violation of the due process clause.

Instead of spreading the welfare burden of subsidizing the needs of tenants suffering financial hardship among the public at large or among landlords as a class, the tenant hardship provisions

discriminate against landlords who have the misfortune to be renting to tenants currently suffering financial hardship. Although the Court in *Nebbia v. New York* did approve discrimination between milk distributors and store owners, it emphasized that such discrimination was justified by the difference in their costs of doing business. *Nebbia v. New York, supra*, 291 U.S. at 530. The California Court of Appeal in *Cotati Alliance for Better Housing v. City of Cotati* approved the discrimination in the amount of rents among landlords inherent in the use of an investment-based instead of value-based criteria in determining the reasonable rate of return that must be afforded. That discrimination was justified as necessary to insure that inflationary factors would not be built into rent control ordinances' rent adjustment mechanism. *Cotati Alliance for Better Housing v. City of Cotati, supra*, 148 Cal. App. 3d 280, 292, 195 Cal. Rptr. 825, 833 (1982). The tenant hardship provisions of the subject ordinance have no bearing on different operating costs or inflationary factors built into the rent adjustment mechanism of the Subject Ordinance. Accordingly, neither *Nebbia v. New York* nor *Cotati Alliance for Better Housing v. City of Cotati* justify the arbitrary discrimination among landlords inherent in application of the tenant hardship provisions.

III

APPLICATION OF THE TENANT HARDSHIP STANDARD VIOLATES THE EQUAL PROTECTION CLAUSE BECAUSE IT ARBITRARILY SELECTS INDIVIDUAL LANDLORDS FOR A SPECIES OF TAXATION TO SUBSIDIZE THE WELFARE OF POOR TENANTS

The burden of alleviating the financial and economic hardship of poor tenants should be borne by the public at large and not by individual landlords. "To charge the cost of operation of state functions conducted for the public benefit to one class of society is arbitrary and violates the basic constitutional guarantee of equal protection of law." *In Re Gerald C.*, 36 Cal. 3d 1, 6, 201 Cal. Rptr. 342, 678 P.2d 917 (1984). *See also, Norwood v. Baker*, 172 U.S. 269, 279 (1898); *Dept. of Mental Hygiene v. Kirchner*, 60 Cal. 2d 716, 36 Cal. Rptr. 488, 388 P.2d 720 (1964); *Dept. of Mental Hygiene v. Hawley*, 59 Cal. 2d 247, 28 Cal. Rptr. 718, 379

P.2d 22 (1963). In *Dept. of Mental Hygiene v. Kirchner* the California Supreme Court reasoned that the maintenance of the mentally ill was the responsibility of the state and characterized a charge imposed upon relatives for the care of the mentally ill committed to state institutions as a species of taxation, holding that:

> A statute obviously violates the equal protection clause if it selects one particular class of persons for a species of taxation and no rational basis supports such classification.

Dept. of Mental Hygiene v. Kirchner, supra, 60 Cal. 2d 716, 722, 36 Cal. Rptr. 488, 492, 388 P.2d 720, 724.[14]

In the above-cited California cases, the Court held that the parent-child relationship was an insufficient basis upon which to impose the burden of the cost of such incarceration. Providing assistance to the poor is just as much a public obligation and function as the incarceration and care of the mentally ill. The landlord-tenant relationship is a far less retional basis for imposition of the burden of financing state functions than the parent-child relationship.

In the case at bar, the California Supreme Court distinguished *Kirchner*, *Hawley* and *In Re Gerald C.* on the grounds that the Court had not applied its analysis of these three cases outside the context of responsible relative reimbursement, and reasoned that it had previously confirmed the propriety of local rent control legislation and of placing the burden of subsidizing tenants on landlords to the extent of the difference between nonregulated *market* rents and regulated *fair return* rents. *Pennell v. City of San Jose, supra*, 42 Cal. 3d at 372. This reasoning ignores the difference between the purpose of the rent control legislation

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[14] The Supreme Court granted certiorari to review this case but, concerned that it lacked jurisdiction, it remanded the case to the California Supreme Court for determination of whether that Court had decided it under the State or Federal Constitution. *Dept. of Mental Hygiene v. Kirchner*, 380 U.S. 194 (1965). On remand the California Supreme Court affirmed that its decision was based on the State Constitution as well as the Federal. *Dept. of Mental Hygiene v. Kirchner*, 62 Cal. 2d 586, 43 Cal. Rptr. 329, 400 P.2d 321 (1965).

previously affirmed (to protect against excessive rents), and the purpose of the tenant hardship provisions of the Subject Ordinance (to reduce rents below a reasonable level to alleviate the economic and financial hardship of individual tenants). The imposition of the burden to support the poor based upon a landlord-tenant relationsip is arbitrary, irrational and violates the equal protection clause.

Appellees respond with the argument that a municipality may impose any distinction which bears some "rational relationship" to a legitimate public purpose, citing *Minnesota v. Cloverleaf Creamery Co.*, 449 U.S. 456 (1981) and *Schad v. Mount Ephraim*, 452 U.S. 61, 68 (1981).[15] Neither case is analogous to the case at bar. *Minnesota v. Cloverleaf Creamery Co.* upheld a ban on plastic non-returnable milk containers but not on paperboard containers, and the court there held the discrimination rational to protect the environment on four separate grounds. In *Schad v. Mount Ephraim*, the court reversed convictions for violations of a zoning ordinance prohibiting live entertainment, as applied to live nude dancing. Although the court indicated that the "rational relationship" test normally applied in zoning cases, it applied a strict scrutiny test because the zoning ban impinged on First Amendment rights of free expression.

Appellees furnish no rationale for imposing the welfare burden arising out of the tenant hardship provisions on individual landlords as a one-on-one subsidy rather than on the entire class of landlords or on the public in general through taxation. Instead, Appellees cite *Nebbia v. New York*, 291 U.S. 502 (1934), *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), *Cotati Alliance For Better Housing*, 148 Cal.App.3d 280, 195 Cal. Rptr. 825 (1983) and *Bowles v. Willingham*, 321 U.S. 503 (1944) as justifying the discrimination inherent in the one-on-one subsidy involved in the San Jose tenant hardship provisions.[16] These cases are all distinguishable. The discrimination involved in *Nebbia v. New York* was based upon different operating costs of different classes of merchants; the *Permian Basis Area Rate Cases* involved the impact of uniform rates on high cost operators, not discrimination between rates based on hardship to individual consumers; and the discrimination discussed in *Cotati Alliance* was based on the "at least debatable" need to prevent building inflationary factors into the rent adjustment mechanism. *Cotati Alliance For Better Housing v. City of Cotati, supra*, 148 Cal.App.3d at 292, 195 Cal.Rptr. at 833. *Bowles v. Willingham* did not address the extent to which the Fifth and Fourteenth Amendments relate to the imposition of rent controls as the court was considering Congress' conceded authority under its war powers stating that:

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[15] Appellee's motion to dismiss or affirm, page 13.

[16] Appellee's motion to dismiss or affirm, page 14-15.

> a nation which can demand the lives of its men and women in the waging of that war is under no constitutional necessity of providing a system of price control on the domestic front which will assure each landlord a 'fair return' on his property.

Bowles v. Willingham, supra, 321 U.S. at 519.

Appellees also reason that since a city could regulate rents charged for low- and medium-priced apartments, and not high-priced units, the same purpose may be accomplished in a more precise fashion by differentiating between hardship and non-hardship tenants on the basis of financial need.[17] It is not at all certain that a city could impose rent ceilings on some apartments and not others based solely upon the amount of rent charged on a certain date. Moreover, imposition of rent ceilings on low priced apartments alone is distinguishable from the one-on-one subsidy compelled by the tenant hardship provisions because across-the-board regulation of low priced apartments would at least spread the burden of subsidizing low income tenants among landlords as a class, and not focus the burden on individual landlords who happen to rent to tenants suffering personal financial hardship.

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[17] Appellants' motion to dismiss or affirm page 15.

IV

APPLICATION OF THE TENANT HARDSHIP PROVISIONS OF THE SUBJECT ORDINANCE VIOLATES THE JUST COMPENSATION CLAUSE BY ALLOCATING THE WELFARE BURDEN UNFAIRLY TO INDIVIDUAL LANDLORDS

A. The tenant hardship provisions operate to force individual property owners to finance the uniquely public function of providing welfare for the needy.

Application of the individual tenant hardship standards contained in Sections 5703.28(c)(7) and 5703.29 of the Subject Ordinance deprives property owners of the reasonable rents that they would receive by applying only the objective cost and value based standards contained in section 5703.28(c)(1) to (6). The right to receive income is a property right that can be the subject of an improper taking under the just compensation clause of the Fifth Amendment. *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 162, 165, (1980). The just compensation clause of the Fifth Amendment applies to states and their political subdivisions through the Fourteenth Amendment. *Chicago, B. & Q. R. Co. v. Chicago*, 166 U.S. 226, 239 (1897). The Supreme Court held in *Armstrong v. United States*, 364 U.S. 40 (1960) that:

> The Fifth Amendment's guarantee that private property shall not be taken for a public use without just compensation was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.

Id., at 49.

The Supreme Court has not developed any set formula for determining when justice and fairness require that economic injuries caused by public actions be compensated by the government rather than disproportionately concentrated on a few persons, and the Court has frequently observed that whether a particular restriction will be rendered invalid by the government's failure to pay compensation depends largely upon the particular circumstances of each case. *Penn Central Transportation Company v. City of New York*, 438 U.S. 104, 124 (1978). The Court stated in *Penn Central* that, "government actions that may be characterized as acquisitions of resources to permit or facilitate uniquely public functions have often been held to constitute 'takings,'" (*Id.*, at 128, citing *U.S. v. Causby*, 328 U.S. 256 (1946), which involved the government use of air space.) The Supreme Court has also characterized government actions facilitating public functions as "takings" in *Armstrong v. United States, supra*, 364 U.S. 40, involving construction of naval vessels, *Norwood v. Baker*, 172 U.S. 269 (1898), involving construction of roadways, and *Monongahela Navigation Co. v. United States*, 148 U.S. 312 (1893), involving construction and maintenance of public waterways.

To develop a workable concept to determine when a "taking" occurs under the just compensation clause, it has been suggested that :

> . . . when economic loss is incurred as a result of government enhancement of its resource position in its enterprise capacity, then compensation is constitutionally required; it is that result which is to be characterized as a taking. But losses, however severe, incurred as a consequence of government acting merely in its arbitral capacity are to be viewed as a non-compensable exercise of the police power.

Sax, *Takings and the Police Power*, 74 Yale L.J. 36, 63 (1964).[18]

Alleviation of the financial and economical hardship of San Jose's poor renters is as much a public function and governmental enterprise as the flight of military aircraft, the building of roads,

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[18] Appellees point out that Professor Sax has modified his views as indicated in Sax, *Takings, Private Property and Public Rights* 81 Yale L. 149 (1971). That modification relates to vindication of public rights involved with physical use of property based on "a recognition of the interconnectedness between various uses of seemingly unrelated pieces of property. . ." (Id. at 150) and does not apply to the taking asserted herewith which does not relate to the physical use of the property.

the construction of naval vessels, and the maintenance of public waterways.

As noted previously, provisions similar to the tenant hardship provisions of the Subject Ordinance have been rejected twice by the New Jersey Supreme Court, which found that the burden of providing special treatment for senior citizens rests with the entire community and cannot be imposed on individual landlords or other tenants in buildings occupied by senior citizens. *Property Owners, Ass'n. etc. v. Township of N. Bergen*, 74 N.J. 327, 378 A.2d 25 (1977) and *Helmsley v. Borough of Fort Lee*, 78 N.J. 200, 394 A.2d 65 (1978).[19] In a case involving application of regulations of the harvesting of wild rice, the Minnesota Supreme Court has held that a taking occurs where land use regulations are designed to benefit a specific public or governmental enterprise. The public enterprise involved was the economic subsidy of Indians who traditionally harvested wild rice by hand. *Pratt v. State of Minnesota, Dept. of Natural Resources*, 309 N.W. 2d 767 (1981).

The tenant hardship provisions of the Subject Ordinance are distinguishable from the kind of zoning and land use regulations that the Court has held to be valid without compensation, in spite of substantial diminutions in value of the property subject to the regulations. In land use cases such as *Agins v. City of Tiburon*, 447 U.S. 255 (1980), *Penn Central Transportation Company v. City of New York, supra*, 438 U.S. 104 (1978) and *Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1926), the cities involved were not acting in an enterprise capacity but were acting in their arbitral capacity, balancing competing physical uses of land for the promotion of the common good. To the extent that the Subject Ordinance operates to prevent unreasonable and excessive rental increases, San Jose is also acting in an arbitral capacity, balancing competing interests of property owners and tenants as a class to guard against rent exploitation arising out of a housing shortage. However, by limiting otherwise reasonable rents to alleviate tenant hardship on a one-on-one basis, San Jose is financing its enterprise function of supporting poor renters. By shifting the burden of financing this enterprise onto individual landlords, it has violated the just compensation clause.

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[19] See discussion pages 14-16, *supra*.

B. The one-on-one subsidy compelled by application of the tenant hardship provisions creates the type of unfairness that the just compensation clause was meant to address

As indicated in *Armstrong v. United States, supra*, 364 U.S. 40, the purpose of the just compensation clause is to assure justice and fairness in the allocation of public burdens. Protection of investment-backed expectations is one of the cornerstones in the review of legislation affecting property rights. *See Energy Reserves Corp., Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 415 (1983); *Penn Central Transportation Company v. New York*, 438 U.S. 104, 124. In the rent control context, restriction of excessive rents does not frustrate reasonable investment-backed expectations, because landlords cannot reasonably expect rents that exploit a housing shortage. However, landlords are justified in expecting rents to provide a just and reasonable return on property they have built or purchased, without being forced to subsidize the welfare needs of individual tenants. That investment-backed expectation is reasonable and warrants protection from enforcement of the tenant hardship provisions of the subject ordinance.

Individual tailoring of the reasonableness standard is offensive to the proper use of the legislative and administrative rate setting process. Consideration of the economic needs of consumers in general and tenants as a class is necessary in any price rate or rent setting process. *Power Comm'n. v. Hope Gas Co.*, 320 U.S. 591, 603 (1944) and *Hutton Park Gardens v. Town Council*, 68 N.J. 543, 350 A.2d 1, 15 (1975). However, rate setting on an individual basis by considering and balancing the individual need of each consumer or tenant appears to be without precedent.

The Subject Ordinance delegates to hearing officers the responsibility of balancing relevant factors to determine whether requested rentals are reasonable or unreasonable. Application of the tenant hardship provisions requires hearing officers to make a legislative determination on a case-by-case basis by weighing the economic need of each tenant prior to determining what is a reasonable rate of return on rental property. On each such occasion, the hearing officer is making the legislative decision for a single tenant's private interest. This is repugnant to the concept that police power legislation is to be exercised for the *general* or *public* health, safety and welfare, not to promote private interest.

In *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234 (1978) the Supreme Court invalidated Minnesota legislation under the impairment of contracts clause in part because it had an extremely narrow focus and was enacted to protect a narrow class and not a broad societal interest. In *Keystone Bituminous Coal Assn. v. Debenedictis*, 107 S.Ct. 1232 (1987) the Supreme Court distinguished Pennsylvania's Bituminous Mine Substance and Land Act, held valid, from the Koller Act, held invalid in *Pennsylvania Coal Co. v. Mahon*, 250 U.S. 393 (1922), because the former was enacted to protect public concerns and the latter to protect private interests. These cases indicate that legislative decisions when made and enacted should promote the general public welfare, not private interest. When applied, police power legislation does benefit some private interests at the expense of others. The problem with the tenant hardship provisions of the Subject Ordinance is that they require hearing officers to make the legislative determination of what rate of return is reasonable to serve the private interest of a single tenant. As early as 1798, Justice Chase in his memorable dictum expressed the Constitution's undisputed condemnation of any law attempting "equalization or redistribution of economic or social power which takes property from A to give it to B" as an impermissible end of legislation. *Chadler v. Bull*, 3 U.S. (3 Dall.) 386, 388 (1798). This is just what the tenant hardship provisions of the subject ordinance require when applied to deny otherwise reasonable rent increases based on an individual tenant's hardship.

Appellees suggest that consideration of tenant financial hardship is fair because Section 5703.28(c)(5) permits the landlord to submit financial information to demonstrate his need for more rent because of his own personal financial hardship.[20] To be relevant and permissible for consideration in the determination of the reasonableness of rents, any financial information provided by the landlord must also pertain to the costs and expenses of operating the rental unit involved or the landlord's investment in that property. Consideration of a landlord's personal financial condition bears the same constitutional infirmity as consideration of a tenant's individual financial hardship.

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[20] See Appellees' motion to dismiss or affirm, p. 11.

C. The takings test involved in zoning and land use cases is not applicable to the taking inherent in confiscatory rent regulation

Appellees' claim that "[p]olice power regulation results in a taking only when the owner of the property involved has been deprived of substantially all reasonable use of his property" citing *Agins v. City of Tiburon*, 447 U.S. 255 (1980), *Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1926) and *Penn Central Trans. Co. v. City of New York*, 438 U.S. 104 (1978).[21] All three cases involve zoning and the regulation of the use and development of land. San Jose's rent ordinance regulates the amount of rent that may be charged for the use of rental property, not the use or development of that property. The validity of police power regulation directed at regulating prices is dependent upon affording the regulated business with a just and reasonable return, not on a showing of the deprivation of all or substantially all reasonable use of the property subject to regulation. *Fisher v. City of Berkeley*, 37 Cal. 3d 644, 209 Cal. Rptr. 682, 693 P.2d 261 (1984), *Birkenfeld v. City of Berkeley*, 17 Cal. 3d 129, 130 Cal. Rptr. 465, 550 P. 2d 1001 (1976); *Hutton Park Gardens v. Town Council*, 68 N.J. 543, 350 A. 2d 1 (1965), and *Helmsley v. Borough of Fort Lee*, 78 N.J. 200, 394 A. 2d 65 (1978).

Application of the just compensation clause in land use cases involves the complex problems of determining what distinct element in the bundle of sticks representing property ownership has been taken, such as the support estate considered in *Keystone Bituminous Coal Assn. v. Debenedictis, supra* , 107 S.Ct. 1232 and the right to develop airspace considered in *Penn Central v. New York, supra*, 438 U.S. 104. Land use regulation cases also involve consideration of reciprocal benefits involved in zoning,

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[21] Appellees' motion to dismiss or affirm, p. 7.

balancing the benefits and burdens of development uses on public facilities and the "interconnectedness between the various uses of seemingly unrealted pieces of property."[22] None of that is involved in the analysis of the tenant hardship provisions of the Subject Ordinance.

When governmental regulation involves a physical intrusion upon land or interference with the right to exclude others, a compensable taking will be found under the just compensation clause even though the diminution in value of the property involved is small. *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982) and *Kaiser Aetna v. United States*, 444 U.S. 164 (1979). In *F.C.C. v. Florida Power Corp.*, 107 S.Ct. 1107 (1987), the Supreme Court recently held that the *per se* taking rule of *Loretto v. Teleprompter Manhattan CATV Corp.*, was not applicable to regulation of rates that may be charged by utility companies for use of poles by cable television systems under the Pole Attachment Act. The court reasoned that the statute considered in *Loretto v. Teleprompter Manhattan CATV Corp.* specifically required landlords to permit permanent occupation of the property, and the Pole Attachment Act did not prohibit utility companies from refusing to enter attachment agreements. However, the Court noted that it did not decide what application *Loretto* would have if utilities were required to enter into, renew or refrain from terminating pole attachment agreements. *FCC v. Florida Power Corp., supra*, 107 S.Ct. 1107, 1112, n. 6.

The Ninth Circuit has recently applied the *per se* taking test of *Loretto v. Teleprompter Manhattan CATV Corp.* and *Kaiser Aetna v. United States*, in *Hall v. Santa Barbara*, 797 F.2d 1493 (9th Cir. 1986), holding that allegations that city rent regulations transferring possessory interests in a mobilehome park from the owners to the tenants stated a claim for inverse condemnation under the just compensation clause. Like most rent control ordinances, the Subject Ordinance contains prohibitions against evictions to prevent its evasion.[23] Because the subject ordinance requires landlords to continue renting to their existing tenants, the case is analogous to the physical taking and occupation cases where a taking will be found regardless of the degree of diminution in the value of the property subject to regulation.

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[22] Sax, *Takings Private Property and Public Rights*, 81 Yale L.J. 149, 150 (1977).

CONCLUSION

Use of the police power to supplant taxation to finance public enterprise is repugnant to the concept of fairness and reasonableness inherent in the due process, equal protection and just compensation clauses. Providing welfare for the needy is a governmental enterprise, the cost of which should be spread through general taxation. It is manifestly unfair and unjust to concentrate the welfare burden on property owners who are charging reasonable rents for the housing services they provide. By piggybacking tenant hardship provisions onto municipal regulation otherwise directed to prevent excessive and unreasonable rental increases, the City of San Jose has misused its police power. Accordingly, the decision of the California Supreme Court should be reversed and the judgment of the trial court affirmed.

MILLER, STARR & REGALIA

By: BURCH FITZPATRICK

---

[23] Section 5706.1 of the subject ordinance states: "Retaliatory Eviction. Possession of a rental unit shall not be recovered by a landlord from a tenant who is not otherwise in default as to the terms of occupancy of said unit, if either: (a) the landlord's dominant motive in seeking to recover possession of such rental unit is retaliation against the tenant for exercising his or her rights under this Chapter; or (b) the dominant motive of the landlord in seeking to recover possession of such rental unit is to evade the purposes of this Chapter."

APPELLEE'S

BRIEF

Supreme Court, U.S.
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⑩

No. 86-753

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1987

RICHARD PENNELL and
TRI-COUNTY APARTMENT HOUSE OWNERS ASSOCIATION,
Appellants,

VS.

CITY OF SAN JOSE and CITY COUNCIL OF
THE CITY OF SAN JOSE,
Appellees.

**On Appeal from the Supreme Court
of the State of California**

BRIEF OF APPELLEES

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QUESTIONS PRESENTED

1. Should this Court decide the constitutionality of a provision in a rent control ordinance that has never been applied, particularly where the named appellant no longer owns rental property which is subject to the ordinance?

2. Is a municipal rent control ordinance which guarantees property owners, at a minimum, a fair and reasonable return on the value of their property constitutionally infirm on its face merely because, under some circumstances, it allows for the consideration of an individual tenant's hardship in deciding what rental increase beyond the fair return should be allowed?

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No. 86-753

In the Supreme Court
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United States

OCTOBER TERM, 1987

RICHARD PENNELL and
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Appellants,

VS.

CITY OF SAN JOSE and CITY COUNCIL OF
THE CITY OF SAN JOSE,
Appellees.

**On Appeal from the Supreme Court
of the State of California**

BRIEF OF APPELLEES

STATEMENT OF THE CASE

In 1979, the City of San Jose enacted a Rental Dispute Mediation and and Arbitration Ordinance[1] which was designed by the City Council to meet the particular needs of the San Jose housing situation. Although Appellants challenge only Sections 5703.28(c)(7) and 5703.29 of the Ordinance, an understanding of the entire regulatory scheme is critical to any analysis of this case.

The San Jose Ordinance is intended to protect tenants in possession from excessive and unreasonable rent increases which could force them to move from their homes. The Ordinance contains a vacancy decontrol provision. Therefore, landlords can set the initial rents charged to new tenants without limit. Section 5703.3.

The Ordinance permits a landlord of a regulated unit to raise the rent of a tenant in possession by as much as eight percent (8%) per year without even being subject to review under the Ordinance. Section 5703.2. If the landlord elects to impose an even greater increase, he can, if he chooses, merely provide notice of the rent increase to the affected tenants. The full amount of the noticed rent increase will go into effect for all tenants, other than those individual tenants who file a timely petition for a hearing. *See* §§ 5703.12 and 5703.27.

---

[1] All statutory references in the City's brief, unless otherwise specified, are to the San Jose Municipal Code as set forth in Appendix E of Appellants' Jurisdictional Statement. However, during the past eight years, the San Jose Ordinance, now codified at Chapter 17.23 of the new Municipal Code, has been amended in a number of ways not relevant to this case. The current Chapter has been lodged with the Clerk of the Court for the Court's convenience, and copies of § 17.23.440 (former § 5703.28) and § 17.23.450 (former § 5703.29) are included in this brief as Appendix A.

If a hearing is requested, the hearing officer must determine whether an increase in excess of eight percent (8%) is reasonable under the circumstances, "taking into consideration that the purpose of this Ordinance is to permit landlords a fair and reasonable return on the value of their property while protecting tenants from arbitrary, capricious or unreasonable rent increases, and under certain circumstances, unjustified economic hardship." Section 5703.28.

In making this Section 5703.28 determination, certain increases are deemed reasonable. Subsection (a) requires that an increase of five percent (5%) plus the pass-through of increased costs for capital improvements, rehabilitation, maintenance and operation be deemed reasonable. Subsection (b) deems certain increased costs of debt services to be reasonable.[2]

If the landlord seeks an increase which is even greater than that allowed by Subsections (a) and (b), the hearing officer is required, using Subsection (c), to determine what increase is "reasonable under the circumstances" by taking into account any of the seven listed factors about which he has received information. In addition to the traditional operating cost factors, the list includes such factors as the rental history of the complex, its physical condition, and the quantity and quality of the maintenance performed, as well as an evaluation of any changes in the housing services provided. Any and all information which the landlord provides will be considered. Tenant hardship is but one of the seven factors.

---

[2] Subsection (b) has been substantially revised in the current Code, see § 17.23.440 (formerly § 5703.28), Appendix A at 2. These changes are not germane to this case.

The task of the hearing officer in applying Subsection (c) is to weigh and balance the information received to determine the allowable rental increase. The hearing officer must allow a rental increase which at least provides for fair return on the value of the property, in accordance with the general rule of Section 5703.28 and the purpose of the Ordinance.[3] Depending on the facts of a particular case, the hearing officer may grant an increment of increase which is greater than that necessary to allow a fair return. In determining whether, or to what extent, such an increment is appropriate, the hearing officer must consider whether the rental increase is arbitrary, capricious or unreasonable. This consideration may involve weighing in the factor of tenant hardship.[4]

Section 5703.29 places the burden of providing economic hardship on the tenant. Where a tenant demonstrates that his household income and monthly household expenses meet the criteria established by the Housing Assistance Payment Program under Section 8 of the Housing and Community Development Act of 1974, the tenant is deemed to be suffering under a financial and economic hardship. This provision does not override the need to weigh and balance relevant factors, nor does it require a hearing officer to disallow any portion of a rent increase.

The provisions of the Ordinance challenged here have never been applied. The present litigation was instituted within weeks of the effective date of the Ordinance. Other than descriptions of Plaintiffs' interests and of the Ordinance itself, the complaint contains no factual allegations. The complaint was verified, upon information and belief, by Plaintiffs' counsel. The City filed a demurrer which, after written and oral argument, was denied as to the tenant hardship provision. The demurrer was granted as to Plaintiffs' allegation that the fees imposed pursuant to Sections 5704.1 and 5704.2 violate the state constitution. The City then filed an answer averring that the tenant hardship provision is constitutional. Plaintiffs thereupon requested and received on February 26, 1980, a Judgment on the Pleadings. The hardship provision has been stayed ever since. Therefore, this Court is presented with absolutely no facts to utilize in assessing the impact of the tenant hardship provision.

SUMMARY OF ARGUMENT

Article III of the United States Constitution requires that there be a "case or controversy" before the Court can review the constitutionality of a local ordinance. This concept of justiciability embodies considerations of standing and ripeness. Neither the named Appellant nor the associational Appellant has standing in this case. Appellant Pennell no longer owns property subject to the Ordinance and the associational Appellant has not presented facts sufficient to state a claim. Particularly since a claim of an unconstitutional taking is central to this case, associational representation is inappropriate. The Association's speculation about the possible impact of the Ordinance does not establish standing.

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[3] See *Pennell v. City of San Jose*, 42 Cal. 3d 365, 370 n.5, 721 P.2d 1111, 1114, 228 Cal. Rptr. 726, 729 (1986). Also the City requests this Court to take judicial notice of Resolution No. 59907 adopted on June 16, 1987. The text of the Resolution, which reiterates this intent, is set forth in full as Appendix B.

[4] Section 5703.29 states in part that "[i]f, on balance, the Hearing Officer determines that the proposed increase constitutes an *unreasonably* severe financial or economic hardship on a particular tenant, he *may* order that the excess of the increase which is subject to consideration under subparagraph (c) of Section 5703.28, or any portion thereof, be disallowed." (Emphasis added)

Furthermore, this case is not ripe for adjudication. The challenged provisions of the Ordinance have never been applied and there are no facts or factual allegations sufficient to merit this Court's review. The Ordinance is quite capable of being applied in a constitutional manner, therefore, it is necessary for Appellants to give the administrative process an opportunity to work before seeking the intervention of this Court.

This Ordinance furthers a proper governmental interest. Among other goals, the Ordinance is intended to prevent landlords from taking unconscionable advantage of the housing shortage in San Jose. Uncontrolled rent increases create housing instability by forcing tenants to move. This can create a class of transient apartment dwellers. Under the circumstances, some tenants may be unable to find affordable housing at all. This displacement of residents has a detrimental effect on the community as a whole.

The Ordinance, in essence, instructs the hearing officer to determine a rent within the "zone of reasonableness" which guarantees the landlord a fair return on the value of his property while considering the tenant's economic or financial hardship. Appellants pejoratively label this rent limitation as a "subsidy" and urge this Court to find it unconstitutional.

The Ordinance cannot result in a taking of property because it stabilizes rents in a non-confiscatory way. There is no requirement under the Constitution that landlords be provided with the highest possible rent. The Ordinance ensures them a fair return on the value of their property, adjusted only within a zone of reasonableness. The landlord clearly is not denied the economically viable use of his land and there has been no showing of how the Ordinance could possible impair investment backed expectations.

The Ordinance provides both substantive and procedural due process. As a form of price control, it adjusts the economic benefits and burdens arising from the housing shortage in a very direct and appropriate way: it protects tenants from excessive rent increases which go beyond a fair and reasonable return to the landlord. Since the landlord is guaranteed a fair return, it is constitutional for a hearing officer, in a fair and impartial hearing, to determine the allowable rent on a case by case basis.

The Equal Protection Clause of the Constitution, in the price control context, does not require absolute undifferentiated treatment of all landlords. The City can make distinctions between classes of landlords as long as the City Council reasonably could have concluded that doing so would promote a legitimate public purpose. The protection of the "hardship" tenants is certainly a legitimate public purpose and it is directly promoted by the specific terms of the Ordinance.

Without question, the City Council could have adopted a stricter, more traditional type of rent control ordinance which would provide all landlords with a lower rate of return than that provided by the current Ordinance. The City Council chose not to do so. Instead, it enacted an ordinance that was designed to more narrowly address the specific concern for hardship tenants. The City, by this Ordinance, is not forcing landlords to subsidize tenants as Appellants allege. On the contrary, the City is merely preventing landlords from maximizing their exploitation of the housing shortage.

Price control of any sort, and rent control in particular, has always been controversial. By definition, such controls protect the consumer at the expense of the provider of goods or services and, to the extent of the difference between the controlled and free market prices, can be characterized as providing a "subsidy." But, looked at from the City's perspective, these controls prevent the provider from taking unfair advantage of market conditions at the expense of the consumer.

The San Jose City Council is most intimately familiar with housing in San Jose. It has properly utilized its police powers to address the serious problems of excessive rents and their effect on our community. In doing so the City Council has fashioned a regulatory scheme which is not confiscatory and which certainly violates neither the due process nor the equal protection requirements of the Constitution. Therefore this appeal should be dismissed or the decision of the California Supreme Court should be affirmed.

ARGUMENT

I.

THIS CASE DOES NOT PRESENT A JUSTICIABLE CONTROVERSY

A. Appellant Pennell Is No Longer Subject To The Ordinance And Therefore Does Not Have Standing In This Case.

It has recently come to the City's attention that Appellant Richard Pennell no longer owns property subject to the San Jose Rental Dispute Mediation and Arbitration Ordinance. *See* San Jose Mercury News, March 3, 1987, at 1B. This fact was called to the attention of counsel for Appellants on May 21, 1987, and has not been controverted. As a result of this changed circumstance, the Court has before it an academic question of law rather than a true case or controversy.

It is appropriate for the Court to decline to reach the merits of a case where, due to changed circumstances, the decision would no longer affect the rights of the Appellant. For example, in *Doremus v. Board of Education,* 342 U.S. 429 (1952), the Court declined to decide a case challenging the reading of Bible verses, where the appellant had graduated from the public schools before the case could be heard, on the grounds that

"this Court does not sit to decide arguments after events have put them to rest." *Id.* at 433. *See DeFunis v. Odegaard,* 416 U.S. 312, 316-17 (1974). The case at bar does not present the exceptional type of situation which is likely by its very nature to evade review. *See Roe v. Wade,* 410 U.S. 113, 125 (1973).

The actual controversy must exist at all stages of review, not merely at the time the complaint is filed. *Preiser v. Newkirk,* 422 U.S. 395, 401 (1975). Since Appellant Pennell is no longer subject to this Ordinance, he lacks the standing to bring this matter before the Court.

B. Associational Appellant Tri-County Apartment House Owners Association Lacks Standing Because It is Unable To Present The Required Facts.

In light of the fact that the named Appellant no longer has the prerequisite standing, it is necessary to examine the standing of the associational Appellant. Tri-County Apartment House Owners Association is described in the complaint as "an unincorporated association organized for the purpose of representing the interests of owners and lessors of real property located in the City of San Jose." The only further factual allegation in the complaint is that real property owned by the Association's members is subject to the terms of the Ordinance. Joint Appendix at 3.

In *International Union, United Auto. v. Brock,* __U.S. __, 106 S. Ct. 2523, 2525 (1986), the Court held that the test set forth in *Hunt v. Washington Apple Advertising Comm'n,* 432 U.S. 333, 343 (1977), is to be utilized in determining associational standing. Under this test, an association has standing to bring suit on behalf of its members if: (1) its members have the standing to sue on their own behalf; (2) the interests it seeks to protect are germane to the association's purpose; and (3) neither the claim asserted nor the relief requested requires the participation of its individual members.

The complaint in the case at bar was verified, not by the Plaintiffs themselves, but on information and belief by counsel for the Plaintiffs. Under California law, such signature means that the attorney has read the pleadings and is informed and believes the matters alleged thereon to be true. The California Code of Civil Procedure states that "[h]owever, in those cases the pleadings shall not otherwise be considered as an affidavit or declaration establishing the facts therein alleged." Cal. Civ. Proc. Code § 446 (West Supp. 1987). Thus, such allegations are hearsay and furnish no proof of the facts stated. *Evangelize China Fellowship, Inc., v. Evangelize China Fellowship, Hong Kong,* 146 Cal. App. 3d 440, 444, 194 Cal. Rptr. 240, 242 (1983); *Star Motor Imports, Inc. v. Superior Court,* 88 Cal. App. 3d 201, 204, 151 Cal. Rptr. 721, 723 (1979).

Therefore, there has been no showing on the record of this case that the associational Appellant has members with standing to sue on their own behalves or that the interests that the associational Appellant seeks to protect are germane to the Association's purpose.

The associational Appellant does not meet the third prong of the *Hunt* test because, by the nature of the challenge to this Ordinance, this case requires the participation of an aggrieved individual member. Since the controverted provision has never been applied, there has been no actual injury. The associational Appellant does not and cannot allege any facts which would enable the Court to determine the rights of the parties in this case. This case would need to be considered only if an individual member had actually been aggrieved by the determination of the hearing officer. At this point in time, it is speculative whether any of the Association's members have hardship tenants who would appeal a rent increase. It is speculative whether the hearing officer would, in fact, reduce any portion of the allowable rent increase based on hardship.

"[U]nadorned speculation will not suffice" for standing purposes. *Simon v. Eastern Ky. Welfare Rights Org.,* 426 U.S. 26, 44 (1976).

It is important that the party seeking relief have a personal stake in the outcome of the controversy so as to assure the necessary "concrete" adverseness. *Baker v. Carr,* 369 U.S. 186, 204 (1962). Where an association seeks adjudication based on a generalized dislike of a legislative program which may possibly impact some of its members, the relationship is "abstract, conjectural and hypothetical." *Allen v. Wright,* 468 U.S. 737, 751 (1984); *Warth v. Seldin* 422 U.S. 490, 501 (1975).

Representational standing is inappropriate in the context of an alleged taking. A taking claim (whether damages are involved or not) is ill-suited for abstract analysis since it seeks vindication of an individual's particular rights. A taking in one factual situation may not be a taking in another, depending on such circumstances as differing investment backed expectations. The Court stressed this point, although it was not directly addressing the question of standing, in *Hodel v. Virginia Surface Mining & Reclamation Ass'n,* 452 U.S. 264 (1981), when it stated:

> We conclude that the District Court's ruling on the "taking" issue suffers from a fatal deficiency: neither appellees nor the court identified any property in which appellees have an interest that has allegedly been taken by operation of the Act. By proceeding in this fashion, the court below ignored this Court's oft-repeated admonition that the constitutionality of statutes ought not be decided except in an actual factual setting that makes such a decision necessary.

Id. at 294-95. In a "taking case" the inquiry "must be conducted with respect to specific property, and the particular estimates of economic impact and ultimate valuation relevant in the unique circumstances." *Id.* at 295.

The associational Appellant has not made any showing that it has a personal stake in the outcome of this case. It has not adequately shown that any of its members own property which will actually be affected by the Ordinance. Instead, it asks the Court for a general advisory ruling. This degree of interest is inadequate to support standing.

C. This Case Lacks Ripeness Because The Challenged Provision Has Never Been Applied.

The request for review by this Court is premature. As stated in *MacDonald, Sommer & Frates v. Yolo County,* __ *U.S.* __, *106 S. Ct. 2561 (1986),* "[a] court cannot determine whether a regulation has gone 'too far' unless it knows how far the regulation goes." *Id.* at 2566. See also *Williamson Planning Comm'n v. Hamilton Bank,* 473 U.S. 172 (1985).

Adherence to this rule is particularly important in cases raising allegations of an unconstitutional taking of private property. Since the taking question must be examined essentially in an ad hoc, factual inquiry, the question properly turns on the circumstances of each case. *Kaiser Aetna v. United States,* 444 U.S. 164, 175 (1979). A case is not ripe when the factual disputes yet to be resolved by local authorities might lead to the conclusion that no taking had occurred. See *First English Evangelical Lutheran Church v. County of Los Angeles,* __ U.S. __, 107 S. Ct. 2378, 2384-85 (1987).

In Virginia Surface Mining, the Court found that because a taking claim arose in the context of a facial challenge to the Virginia Surface Mining Act, the claim presented no concrete and immediate controversy concerning the Act's application to the particular surface mining operation nor its effects on specific parcels of land. "If Appellees were to seek administrative relief under these procedures, a mutually acceptable solution might well be reached with regard to individual properties, thereby obviating any need to address the constitutional questions." *Virginia Surface Mining,* 452 U.S. at 297.

The case at bar perfectly illustrates the reason for the rule. It is not possible to determine whether or under what circumstances the tenant hardship provision will ever be applied; whether it will have an effect which is even measurable; or what, on balance, will be the return allowed to the individual landlord.

Adequately concrete allegations are also necessary to enable a full assessment of the due process and equal protection arguments. See *Pace Resources, Inc. v. Shrewsbury Township,* 808 F.2d 1023, 1035 (3d Cir.), *cert. denied,* __ U.S. __, 107 S. Ct. 2482 (1987). A due process challenge was dismissed as "premature" in *Hodel v. Indiana,* 452 U.S. 314 (1981), where appellees had "made no showing that they were ever assessed civil penalties under the [Surface Mining] Act, much less that the statutory prepayment requirement was ever applied to them or caused them any injury." *Id.* at 335-36. At this stage of the litigation, in the case at bar, there are no facts at all before the Court. Therefore, it is inappropriate to speculate whether there might be a substantial disparity in the treatment of landlords or whether the Ordinance might operate in an arbitrary or capricious manner. *Pennell v. City of San Jose,* 42 Cal. 3d 365, 374, 721 P.2d 1111, 1117-18, 228 Cal. Rptr. 726, 732-33 (1986).

Appellants argue that the apparent lack of ripeness should be ignored because the amount by which the challenged provision would reduce the rental income is so small that no landlord will file suit. Brief of Appellants at 11 n.11. However, the case at bar was filed without Appellants even knowing whether the provision would ever have a discernible impact on anyone.

The purpose of Article III of the Constitution is to "assure that the legal questions presented to the court will be resolved, not in the rarified atmosphere of a debating society, but in a concrete factual context conducive to a realistic appreciation of the consequences of judicial action." *Valley Forge College v. Americans United*, 454 U.S. 464, 472 (1982). Based on both the lack of standing and lack of ripeness, this Court should find that there is no case or controversy at this time.

D. Issues Raised For The First Time In This Court Should Not Be Considered.

This Court does not decide issues which were not raised in the courts below. *Tacon v. Arizona*, 410 U.S. 351, 352 (1973); *Cardinale v. Louisiana*, 394 U.S. 437 (1969). Certain issues not raised below, are raised here for the first time by Appellants and various Amici Curiae. These issues include:

1. The question of a physical taking;
2. Issues relating to eviction limitations;
3. Challenges to the reasonableness of rent control in general;
4. Issues relating to method of calculating return; and
5. Procedural due process.

If the Court determines that Appellants have standing and the case is ripe for decision, then issues not raised below should not be considered by the Court.

II.

THIS ORDINANCE IS BASED ON A PROPER PUBLIC PURPOSE

A. The San Jose Ordinance Prevents Exploitation Of A Housing Shortage.

Courts have long acknowledged the general purposes served by rent control regulation. "Housing is a necessary of life. All

the elements of a public interest justifying some degree of public control are present." *Block v. Hirsh*, 256 U.S. 135, 156 (1921). "Prevention of the exploitation of shortages of available housing by precluding excessive rent is a legitimate governmental purpose." *Cotati Alliance for Better Housing v. City of Cotati*, 148 Cal. App. 3d 280, 293, 195 Cal. Rptr. 825, 833 (1983). Concern for the effects of displacement on low income senior and disabled tenants have been found to be a proper governmental interest. *Edgewater Investment Associates v. Borough of Edgewater*, 103 N.J. 227, 235, 510 A.2d 1178, 1182 (1986).

San Jose is a rapidly growing metropolitan center in the heart of Silicon Valley. Its population is now almost 720,000. Historically, San Jose has been a "bedroom" city. The City Council, in enacting this Ordinance, found that there is a growing shortage of and an increasing demand for housing in the City and that with inflation, the cost of developing new housing has risen substantially. Section 5701.2. The Ordinance was intended to provide merely the degree of control necessary to meet San Jose's goals. Therefore, it was designed to balance the interests of the individual tenant and the individual landlord by providing a fair return to the landlord and, at the same time, protecting tenants from unwarranted and excessive rent increases.

B. The Hardship Provision Protects Tenants From Involuntary Displacement Resulting From Excessive Rent Increases.

Appellants' basic argument (whether framed from the perspective of taking, due process or equal protection) is that Appellants can see no rational purpose which advances a proper governmental interest for including the tenant hardship provision as part of the City's rent ordinance.

However, among other goals,[5] San Jose's Ordinance is designed to provide housing stability. The City Council can appropriately believe that the unreasonable escalation of rents in response to market conditions could force tenants to move on a periodic basis because their incomes will not keep pace with the rent increases.[6] The result would be that multifamily housing would become transient in nature and residents would lack the continuity and sense of neighborhood critical to San Jose's preferred life style.

Displacement of residents has a negative impact on the community as a whole as well as disrupting the lives of the displaced individuals. The City Council legitimately can be concerned that a pattern of transience would affect the schools, the crime rate and the sense of community. Escalating rents can drive low and moderate income households out of racially and economically integrated neighborhoods, forcing the displaced tenants into over-crowded, substandard ghettos.

The worst effect of escalating rents is the problem of the homeless. There is no question that a significant number of the homeless in our community are families unable to afford any decent shelter.[7] Putting aside entirely the concern of the City Council for homeless individuals, homelessness affects the public in general. The homeless tend to congregate in the downtown areas. They create problems of sanitation and health that impact the entire community. Their visible presence discourages use of certain areas, directly impacting the surrounding businesses. For a city trying to revitalize its downtown and attract economic development, prevention of homelessness is critical to preserving the public health, safety and general welfare.

In order to address these concerns, the City's Ordinance is constructed so that an excessive rent is one which is more than a landlord needs in order to receive a fair return *and* which imposes an unjustifiable burden on the tenant. If the increase is not more than the particular tenant can afford to pay, it is less likely to be found excessive.

Appellants take the position that the only legitimate purpose of rent control is to provide a fair return to the property owner and that the tenant hardship provision "has no rational relationship to the reasonableness of the *rate* of return afforded landlords." Brief of Appellants at 13. However, protecting tenants from excessive rent increases which could force them to move from their homes is a legitimate, general public purpose.

Similar purposes have been upheld by the courts. For example, a price control act with the avowed purpose to prevent "speculative, unwarranted, and abnormal" price increases and

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[5] Because there is no record on the legislative intent, this Court can presume a reasonable basis and hypothesize justifications for the enactment. See *McDonald v. Board of Election Comm'rs*, 394 U.S. 802, 809 (1969); *Goldblatt v. Town of Hempstead*, 369 U.S. 590, 595-596 (1962).

[6] Rent increases unrelated to reinvestment in the property, have been identified as the most important single factor in involuntary displacement. LeGates & Hartman, *Displacement*, 15 Clearinghouse Review 207, 215 (1981).

[7] *Clark v. Community for Creative Non-Violence*, 468 U.S. 288, 304 n.4 (1984) (Marshall, J., dissenting) (citing the New York Times, May 2, 1984, estimate that there were approximately 2-3 million homeless individuals in this country). Reportedly, 28% of the homeless are families with children. See *Hansen v. McMahon*, ___ Cal. App. 3d ___, 238 Cal. Rptr. 232 (1987).

"to protect persons with relatively fixed and limited incomes" from undue impairment of their standard of living was upheld in *Yakus v. United States*, 321 U.S. 414, 420 (1944). Preventing "exactions of unjust, unreasonable and oppressive rents" which would result in "uncertainty, hardship and dislocation" was held to be a valid legislative purpose in *Bucho Holding Co. v. Temporary State Housing Rent Comm'n*, 11 N.Y.2d 569, 474, 184 N.E.2d 569, 571, 230 N.Y.S.2d 977, 980 (1962).

C. Appellants May Not Superimpose Their Own Socio-Economic Judgment For That Of The City Council.

There is no question that Appellants object to the social and economic policy enacted by the San Jose City Council. However, the proper way to seek a change in that policy is through the political process, not through the courts. See *Bowen v. Gilliard*, ___ U.S. ___, 107 S. Ct. 3008 (1987); *Williamson v. Lee Optical, Inc.*, 348 U.S. 483, 488 (1955).

This Court has stated many times in different ways that the wisdom of socioeconomic legislation is not to be debated in the federal courts. *See Hodel v. Indiana*, 452 U.S. 314, 333 (1981); *New Orleans v. Duke*, 427 U.S. 297, 303 (1976); *Nebbia v. New York*, 291 U.S. 502, 537 (1934). "In such cases the legislature, not the judiciary, is the main guardian of the public needs to be served by social legislation." *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229, 239 (1984).

III.

THIS ORDINANCE DOES NOT RESULT IN A TAKING.

The basic analysis utilized to determine whether an unconstitutional "taking" has occurred is an ad hoc factual inquiry into the circumstances of the case. The three factors considered to be of "particular significance" are (1) the economic impact of the regulation on the claimant; (2) the extent to which the regulation has interfered with distinct investment backed expectations; and (3) the character of the governmental action. *Kaiser Aetna v. United States*, 444 U.S. 164, 175 (1979); *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 124 (1978).

Consideration of the first two factors varies based on the character of the governmental action. The cases fall into four distinct types of governmental action (economic regulation, nuisance abatement,[8] physical occupation and use regulation[9]) which are subject to different analyses.[10] The nature of the

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[8] Since no one has the right to use his property in a way which creates a nuisance or causes harm to others, prevention of such harm to the community does not really "take" anything. *Keystone Bituminous Coal Ass'n v. DeBenedictis*, ___ U.S. ___, 107 S. Ct. 2378 (1987). While from the City's perspective, price gouging and exploitation of the housing shortage are a danger to the economic stability of the community, and are therefore a nuisance, economic exploitation is not analyzed from that perspective by the Court.

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[9] The use regulation category involves restrictions on the use or development of property. The tests applied in this context are not fully appropriate in the context of economic regulation. Nonetheless, the San Jose Ordinance is not a taking under this analysis either.

Use regulation is found not to effect a taking if it substantially advances legitimate state interests and does not deny an owner the economically viable use of his land. *Nollan v. California Coastal Comm'n*, ___ U.S. ___, 107 S. Ct. 3141 (1987). The tenant hardship provision directly and substantially furthers the legitimate governmental interest in preventing landlords from exploiting a housing shortage at the expense of tenants who are unable to absorb the increase and who will therefore possibly face dislocation. There can be no question that the challenged regulation does not deprive the landlord of an economically viable use of his land nor unreasonably impair its value so as to interfere with investment backed expectations. *Agins v. Tiburon*, 447 U.S. 255, 260 (1980); *Penn Central*, 438 U.S. at 130-131. The landlord continues to fully governmental action at issue here falls squarely into the category of economic regulation.

A. The San Jose Ordinance Is Constitutional As An Economic Regulation Because It Is Not Confiscatory.

In February of this year, in *FCC v. Florida Power Corp.*, ___ U.S. ___, 107 S. Ct. 1107 (1987), the Court reiterated its holding that price control regulation is constitutionally permissible. Such regulations may stringently limit the return on investment but "[s]o long as the rates or rents are not confiscatory, the Fifth Amendment does not bar their imposition." *Id.* at 1113. In applying these principles this Court upheld a limitation on the rate which utilities can charge cable television companies for use of utility poles. If Appellants here are correct that the San Jose Ordinance provides a "subsidy," then the rental limitations upheld in *Florida Power Corp.* provided a similar "subsidy" to the cable television companies.

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*(* Cont'd From Page 19)*
utilize the property for its intended purpose and is not foreclosed from collecting and even raising rents. By the terms of the Ordinance, the landlord is assured a fair return on his property. *Pennell v. City of San Jose*, 42 Cal. 3d 365, 370 n.5, 721 P.2d 1111, 1114, 228 Cal. Rptr. 726, 729 (1986).

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[10] Appellants propose that this Court adopt a new "workable" concept to determine when a "taking" has occurred based on the theory promulgated by Professor Sax, *Takings and the Police Power*, 74 Yale L.J. 36 (1964). This analysis turns on a distinction between government enhancing its resource position in its "enterprise" capacity and government in its "arbitral" capacity. However, even if this Court were to apply this theory to the case at bar, the City is clearly within its arbitral capacity - balancing the economic interest of landlord and tenant for the public good. The City here does not acquire anything for its own use. Indeed, in listing typical arbitral functions of the government, Professor Sax states, "as between tenant and landlord it may adjust prices." *Id.* at 63. The fact that a distinction is made between hardship and non-hardship tenants does not change the character of the function.

The San Jose Ordinance is not confiscatory; on the contrary, it assures the landlord a fair return on the value of the property. It enables the landlord an even greater return, if such is reasonable under the circumstances, based on the weighing and balancing of all relevant factors. *Pennell v. City of San Jose*, 42 Cal. 3d 365, 371 n.6, 721 P.2d 1111, 1114-15, 228 Cal. Rptr. 726, 729-30 (1986).[11]

The Court fully discussed the relationship of the Taking Clause to economic regulation in *Connolly v. Pension Benefit Guaranty Corp.*, ___ U.S. ___, 106 S. Ct. 1018 (1986).

> In the course of regulating commercial and other human affairs, Congress routinely creates burdens for some that directly benefit others. For example, Congress may set minimum wages, control prices, or create causes of actions that did not previously exist. Given the propriety of the governmental power to regulate, it cannot be said that the Taking Clause is violated whenever legislation requires one person to use his or her assets for the benefit of another.

Id. at 1025.

In *Connolly*, the Court analyzed whether the retroactive application of the withdrawal liability provisions of the Multi-Employer Pension Plan Amendments Act of 1980 was a taking of private property. This Act requires an employer who is withdrawing from a Multi-Employer Pension Plan to pay a fixed sum to the pension plan. This sum is the employer's proportionate share of the fund's unfunded vested benefits calculated as the difference between the present value of the vested benefits and the current value of the plan's assets.

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[11] The interpretation of an ordinance by the highest court of a state becomes a part of the statute for purposes of determining its validity. *Allied Stores of Ohio v. Bowers*, 358 U.S. 522 (1959).

The appellants in *Connolly* argued that the imposition of the noncontractual withdrawal liability violated the Taking Clause "by requiring employers to transfer their assets for the private use of pension trusts" without compensation. *Id.* at 1024. While the Court agreed that an employer subject to withdrawal liability is permanently deprived of assets to satisfy these statutory obligations, it rejected the notion that a statutory liability to a private party always constitutes an uncompensated taking prohibited by the Fifth Amendment, stating that "Congress routinely creates burdens for some that directly benefit others." *Id.* at 1025. The Court noted that the government does not physically invade nor permanently appropriate any of the employer's assets for its own use. Instead, it adjusts the benefits and burdens of economic life to promote the common good, which is not a taking.

The San Jose Ordinance adjusts the benefits and burdens of economic life to substantially advance a variety of legitimate governmental interests, including concern about the displacement of tenants who live on fixed and limited incomes and who would be unable to afford to continue to live in their current homes if excessive rental increases were imposed.

Appellants contend that a taking has occurred based on *Webb's Fabulous Pharmacies, Inc. v. Beckwith,* 499 U.S. 155 (1980). Brief of Appellants at 23. In that case, the County appropriated the interest on funds which had been interpled and deposited with the court. Nothing in that action adjusted the benefits and burdens of economic life for the common good. "No police power justification [was] offered for the deprivation. Neither the statute nor appellees suggest[ed] any reasonable basis to sustain the taking of the interest earned by the interpleader fund." *Id.* at 163. The County merely took advantage of the fortuitous circumstance that it had possession of the money to keep the interest for its own use.

The case at bar is readily distinguishable. Landlords who take advantage of the housing shortage to charge unreasonable and excessive rents directly create the problem which the City is attempting to solve. Limiting this excessiveness is not unfair nor unjust.

B. There Has Not Been A Physical Taking.

Appellants have contended for the first time in this Appeal that there is a physical taking.[12] Brief of Appellants at 29-30. Their theory is based on the fact that the San Jose Ordinance contains provisions prohibiting retaliatory eviction so that landlords are unable to evict tenants because they assert financial hardship. See § 5706.1. Since Appellants did not raise this issue in the courts below, this argument should not be considered by the Court at this time.[13] In any event, the argument is patently unmeritorious. The San Jose Ordinance includes a vacancy decontrol provision which permits landlords to set uncontrolled initial rents for new tenants in voluntarily vacated units. Therefore the prohibition against retaliatory eviction is necessary to prevent landlords from evicting tenants solely in order to raise rents.

This Court stated in *Loretto v. Teleprompter Manhattan CATV Corp.,* 458 U.S. 419 (1982), that neither the rent con-

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[12] Appellants concede, however, that the taking asserted herein does not relate to the "physical use" of the property. Brief of Appellants at 24 n.18.

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[13] Appellants cite to the case of *Hall v. City of Santa Barbara,* 797 F.2d 1493 (9th Cir. 1986), as authority for this argument. A petition for certiorari in that case is expected to be filed with this Court in August 1987.

trol law in *Block v. Hirsh*, 256 U.S. 135 (1921), nor the emergency housing law in *Edgar A. Levy Co. v. Siegel*, 258 U.S. 242 (1922), authorized a permanent occupation, despite eviction limitations. "The preference given to the tenants in possession is an almost necessary incident of the policy, and is traditional in English law. if the tenant remained subject to the landlord's power to evict, the attempt to limit the landlord's demands would fail." *Block v. Hirsh*, 256 U.S. at 157-158 (1921). See also *Troy Ltd. v. Renna*, 727 F.2d 287 (3d Cir. 1984); *Taylor v. Brown*, 137 F.2d 654 (Emer. Ct. App.), *cert. denied*, 320 U.S. 787 (1943) (cited with approval in *Parker v. Fleming*, 329 U.S. 531 (1947)); *Flynn v. Cambridge*, 383 Mass. 152, 418 N.E.2d 335 (1981); *Jambes v. Veale*, 132 Misc. 2d 481, 504 N.Y.S.2d 982 (1986).

The eviction limitation, on its face, substantially advances the legitimate purpose of preventing evasion or circumvention of the rent control ordinance. Furthermore, even if the Ordinance did not contain a retaliatory eviction provision, the fact that an eviction was retaliatory or evasive could be asserted as an equitable defense in an unlawful detainer proceeding. *Schweiger v. Superior Court*, 3 Cal. 3d 507, 476 P.2d 97, 90 Cal. Rptr. 729 (1970); *Edwards v. Habib*, 397 F.2d 687 (D.C. Cir. 1968), *cert. denied*, 393 U.S. 1016 (1969).

The eviction limitation comes in to play only where the landlord has in fact invited the tenancy. It does not preclude eviction for cause and it does not deprive the landlord of economically viable use of his property because the landlord has the right to receive rent which provides him with a fair return. This limitation is necessary to effectuate the purposes of the Ordinance and does not convert the tenant hardship provision into a physical taking.

IV.

THIS ORDINANCE DOES NOT VIOLATE DUE PROCESS

The test of due process in the context of price control legislation was definitively set forth in *Nebbia v. New York*, 291 U.S. 502, 538-539 (1934). Due process demands that the law not be unreasonable, arbitrary or capricious; that is, the means selected must have a real and substantial relation to the object sought. However, a law is not "unreasonable" just because Appellants disagree with its correctness as social policy.

A. Appellants Have Not Met The Burden Of Showing This Ordinance To Be Unreasonable, Arbitrary Or Capricious.

The standard for due process review of economic regulation by this Court was summarized in *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1 (1976):

> It is by now well established that legislative Acts adjusting the burdens and benefits of economic life come to the Court with a presumption of constitutionality, and that the burden is on one complaining of a due process violation to establish that the legislature has acted in an arbitrary and irrational way.

Id. at 15.

A basic rule of statutory interpretation is that it must be assumed that a regulation will be applied in a manner consistent with the Constitution unless there is definite language to the contrary. *American Power and Light Co. v. SEC*, 329 U.S. 90, 108 (1946). A regulation is invalid on its face "when its terms will not permit those who administer it to avoid confiscatory results in its application to the complaining parties." *Birkenfeld v. City of Berkeley*, 17 Cal. 3d 129, 165, 550

P.2d 1001, 1027, 130 Cal. Rptr. 465, 491 (1976); *Fisher v. Berkeley*, 37 Cal. 3d 644, 679, 693 P.2d 261, 290, 209 Cal. Rptr. 682, 710-11 (1984), *appeal dismissed in part*, 471 U.S. 1124 (1985), *aff'd*, 475 U.S. 260 (1986). In fact, the San Jose Ordinance grants the landlord a fair return, and therefore it is constitutional on its face. *Pennell v. City of San Jose*, 42 Cal. 3d 365, 370 n.5, 721 P.2d 1111, 1114, 228 Cal. Rptr. 726, 729 (1986).

Appellants in this case predicate their position that the Ordinance violates due process on their contention that application of the listed factors, other than tenant hardship "determines the reasonable rental value of the unit involved, which by definition cannot be excessive" and that application of the tenant hardship factor "will reduce the rent below the objectively calculated reasonable rental value" making the more limited increase unreasonable per se.[14] Brief of Appellants at 12. This theory misapprehends both the law and the way the Ordinance actually operates.

Fair return is not determined by artificial rules; no particular formula or method is required. *Power Comm'n. v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942); *Bluefield Water Works & Improvement Co. v. Public Service Comm'n*, 262 U.S. 679, 691-692 (1923). "Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling." *Power Comm'n. v. Hope Gas Co.*, 320 U.S. 591, 602 (1944).

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[14] A similar argument was made in the case of *Town Taxi, Inc. v. Police Comm'r*, 377 Mass. 576, 387 N.E.2d 129 (1979), relative to a taxi fare discount for elderly and handicapped persons. The claim failed because no facts were presented to prove that the rate structure was set in this fashion.

The structure of San Jose's Ordinance is analogous to that of the Natural Gas Act of 1938 (15 U.S.C. § 717 *et seq.*), which directs that all rates and charges for natural gas are to be "just and reasonable." The Federal Power Commission is empowered to investigate the rates charged by any natural gas company and after a hearing to determine just and reasonable rates. In *Power Comm'n v. Natural Gas Pipeline Co.*, the Court noted that "[b]y long standing usage in the field of rate regulation 'the lowest reasonable rate' is one which is not confiscatory in the constitutional sense." 315 U.S. at 585. There can be a "zone of reasonableness within which the Commission is free to fix a rate varying in amount and higher than a confiscatory rate." *Id.* at 586. The Commission can also "decrease any rate which is not the 'lowest reasonable rate.' " *Id.* "Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by the particular circumstances." *Id.* at 587.

The zone of reasonableness has been described as being "bounded at one end by the investor interest against confiscation and at the other end by the consumer interest against exorbitant rates." *Washington Gas Light Co. v. Baker*, 188 F.2d 11, 15 (D.C. Cir. 1950), *cert. denied*, 340 U.S. 952 (1951).

San Jose could have chosen to impose rent regulations which allow the landlords no more than "the lowest reasonable rate." Instead it chose to allow pragmatic adjustments within "the zone of reasonableness" based on the particular circumstances. In making rate determinations, it is proper to consider all relevant factors, including the impact on the consumer, as long as at least "the lowest reasonable rate" has been ensured. The fact that the landlord does not invariably receive the highest rent within the zone of reasonableness does not result in a violation of due process.

B. It Is Constitutional For The Hearing Officer To Set Individualized Rents Within The "Zone Of Reasonableness."

Appellants contend that consideration of the individual tenant's needs in setting the rent renders the Ordinance unconstitutional. However, rate regulation is typically administered by determining a rate which is "just and reasonable" in its application to a person or company subject to the regulation. *See Power Comm'n v. Natural Gas Pipeline Co.*, 315 U.S. 575 (1941). While the individual consumer's needs are not typically before the administrator, the impact on consumers underlies all price and rate control. As the Court stated in *Power Comm'n v. Hope Gas Co.*, "the fixing of 'just and reasonable' rates, involves a balancing of the investor and the consumer interests." 320 U.S. at 603. The fact that the individualization applies not only to landlords but also to tenants does not make this Ordinance unreasonable, arbitrary or capricious.

As the California Supreme Court pointed out, San Jose could have exempted all upper-income housing from its regulatory scheme.[15]

> The purpose of a so-structured regulatory scheme would be to assist only those who need assistance; the assumption underlying such a scheme would be that financially needy tenants reside in low- and medium-priced units and not in high-priced units. The present ordinance addresses the same purpose in a more precise fashion by differentiating between hardship and non-hardship tenants, through the rational means of distinguishing between their respective landlords.

Pennell, 42 Cal. 3d at 374, 721 P.2d at 1117, 228 Cal. Rptr. at 732.

The San Jose Ordinance is designed to weigh the individual investor and consumer interests in setting a non-confiscatory rent within the zone of reasonableness. The object of the Ordinance is to prevent excessive rent increases which are beyond the means of the current tenants and might result in their being displaced. The tenant hardship provision has a real and substantial relation to that object. Therefore, the use of a method which considers the impact on the individual consumer in setting the limit on individual rent increases meets the *Nebbia* test of due process.

C. The San Jose Ordinance Is A Form Of Price Control Regulation Which Permissibly Shifts Economic Burdens.

All price control regulation limits the profits of the provider by reducing the amount which the consumer would otherwise have to pay to the provider. This shift of economic burdens, which is the essence of price control, is characterized by Appellants as a "subsidy." The City of San Jose permits landlords to profit from the housing shortage by raising rents except where an excessive rent increase will create an unreasonable impact on an individual tenant in possession. Since the hearing officer will find a rent increase "excessive" only with regard to a tenant who participates in the process, the landlord can increase the rent of a unit without limit for any tenant who does not file a petition to trigger a review under the Ordinance. *See* § 5703.27. Because the Ordinance is attempting to prevent the societal effects of involuntary displacement, the determination of what is "excessive" in such a case may properly include consideration of the tenant's ability to pay the increase. This is not, as stated in Brief of Appellants at 27, an impermissible attempt to take property "from A to give to B," but instead is a permissible regulation which prevents A from exploiting the housing shortage by imposing an excessive rental increase on B.

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[15] For cases validating the exclusion of high-price or luxury apartments from regulatory control ordinances, see *Kalaydjian v. City of Los Angeles*, 149 Cal. App. 3d 690, 197 Cal. Rptr. 149 (1983); *Gauthier v. Gabel*, 44 Misc. 2d 887, 255 N.Y.S.2d 200 (1964), *aff'd*, 16 N.Y.2d 720, 209 N.E.2d 723, 262 N.Y.S.2d 105 (1965); *Russell v. Treasurer and Receiver General*, 331 Mass. 501, 120 N.E.2d 388 (1954); *Marshal House, Inc. v. Rent Control Board*, 358 Mass. 686, 266 N.E.2d 876 (1971).

By enabling the hearing officer to take tenant hardship into consideration, the Ordinance makes it unnecessary for San Jose to require a greater degree of regulation in order to achieve its purpose.[16] The Court should not find that by allowing the return to be an amount which is greater than that which is constitutionally required, the Ordinance somehow violates due process. As the Court found in *Posadas de Puerto Rico Associates v. Tourism Co.*, ___ U.S. ___, 106 S. Ct. 2968, it would "surely be a strange constitutional doctrine" to allow the power to impose a certain degree of regulation and yet forbid the adoption of a less intrusive regulation. *Id.* at 2979.

Recently, in *Bowen v. Gilliard*, ___ U.S. ___, 107 S. Ct. 3008 (1987), this Court found that given the unquestioned right of the government to reduce welfare benefits generally, a reduction to some recipients, based on the fact that their children receive support payments from non-custodial parents, was not impermissible. Similarly, given the unquestioned

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[16] In fact, because certain landlords were exploiting the liberal approach of this Ordinance, regulation of mobilehome parks was removed from this Ordinance in 1985. San Jose rent control regulations for mobilehome parks now require an automatic hearing for all tenants if the landlord imposes an increase of more than five percent (5%). Any such rent increase is strictly limited on a net operating income basis. *See* San Jose Municipal Code Chapter 17.22.

right of the City to limit rent increases to the lowest amount necessary to provide a fair return, it is not impermissible to base the increase allowed to some landlords on the fact that their tenants suffer financial or economic hardship where the resulting rent increase will provide a fair return.

D. Consideration Of Tenant Hardship Is Not Unreasonable Or Arbitrary.

Appellants rely on the New Jersey cases of *Property Owners Ass'n v. Township of N. Bergen*, 74 N.J. 327, 378 A.2d 25 (1977), and *Helmsley v. Borough of Fort Lee*, 78 N.J. 200, 394 A.2d 65 (1978), for the proposition that "it is not constitutional to compel landlords to subsidize special treatment for needy senior citizens." Brief of Appellants at 14. Those cases are clearly distinguishable from the case at bar because those challenged ordinances did not guarantee the landlord a fair return.[17] The court found that the manner in which rents for low income seniors were frozen in *North Bergen* and the rigid rent increase ceiling imposed in *Helmsley* could result in confiscatory rates of return. These cases most assuredly do not stand for the broad proposition suggested by Appellants that it is unconstitutional to consider tenant hardship in the rent control context.

The more recent New Jersey cases, *Edgewater Investment Associates v. Borough of Edgewater*, 103 N.J. 227, 510 A.2d 1178 (1986), and *Troy Ltd. v. Renna*, 727 F.2d 287 (3d Cir. 1984), have upheld the New Jersey Senior Citizens and Disabled Protected Tenancy Act which precludes eviction of low- and moderate-income seniors and disabled tenants from rent controlled units for 40 years after the units have been converted into condominiums. The New Jersey Supreme Court found that "[i]t cannot be disputed that a 40-year protected tenancy advances the salutary goal of protecting from eviction those elderly or disabled tenants who lack the financial resources to relocate." *Edgewater Investment Associates*, 103 N.J. at 235, 510 A.2d at 1182.

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[17] See *Cold Indian Springs Corp. v. Township of Ocean*, 154 N.J. Super 75, 380 A.2d 1178 (1977).

The Third Circuit Court of Appeals considered the Act's broad remedial purpose of protecting these citizens from the disruption of eviction which is costly for themselves and for the state in general, and particularly for those persons who are often limited to fixed incomes, to be a "legitimate and reasonable public purpose." *Troy Ltd.*, 727 F.2d at 298. The fact that some landlords were more stringently regulated due to the happenstance of having low-income senior or disabled tenants did not deter the New Jersey Supreme Court or the Third Circuit Court of Appeals from finding that the New Jersey Protected Tenancy Act is not facially unconstitutional, either as an impairment of the obligation of contract or as a taking of property without compensation. For similar results see *Vitaliotis v. Mossesso*, 130 Misc. 2d 141, 495 N.Y.S.2d 111 (N.Y. Civ. Ct. 1985).

E. The Hardship Provision Is Not Burdensome To Apply.

Appellants now contend that the tenant hardship provision violates procedural due process because landlords do not have a reasonable means for investigating the hardship factor and no discovery procedures are provided under the Ordinance. This argument was not made below and should not be considered here, particularly in light of the absence of any factual record.

This argument, in any event, is without merit. "Due process is flexible and calls for such procedural protections as the particular situation demands." *Morrissey v. Brewer*, 408 U.S. 471, 481 (1972). *See also Mathews v. Eldridge*, 424 U.S. 319, 334-335 (1976). The Court should note that the tenant

bears the burden of providing evidence satisfactory to the hearing officer to demonstrate that household income and monthly housing expenses meets the HCD Section 8 criteria or to demonstrate economic or financial hardship. See § 5703.29. The landlord can question the adequacy, veracity or authenticity of the information during the hearing. Likewise, the landlord submits information to demonstrate the reasonableness of a proposed rent increase and tenants cannot avail themselves of discovery to contradict these submittals. They are limited to raising questions about them during the hearing process.[18]

Landlords are assured by California law that there will be an adequate factual basis before any hearing officer applies the tenant hardship provision. Any decision of the hearing officer is subject to review pursuant to the state administrative mandamus provision. Cal. Civ. Proc. Code § 1094.5 (West 1980). The reviewing court will determine if there has been an abuse of discretion by determining whether there are adequate findings which are supported by substantial evidence in the record. *Topanga Ass'n for a Scenic Community v. County of Los Angeles*, 11 Cal. 3d 506, 514-515, 522 P.2d 12, 17, 113 Cal. Rptr. 836, 840-41 (1974).

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[18] Section 5705.4(a) provides that the Ordinance is to be implemented with a set of regulations which are not part of the record in this case. These regulations, promulgated by an advisory commission composed of landlords, tenants and neutrals (§ 5705.2), allow the hearing officer to require sworn testimony (Regs § 3.04.01), to require the submission of additional evidence (Regs § 3.04.04), and the regulations direct the hearing officer to give parties a reasonable opportunity to respond to new documents and issues presented (Regs § 3.04.03).

V.

THIS ORDINANCE DOES NOT DENY EQUAL PROTECTION

An equal protection challenge to commercial regulation which does not involve a fundamental interest or a classification based on a suspect criterion, is tested under the traditional standard of rationality. The statute must be sustained if the legislative body reasonably could have concluded that the challenged classification would promote a legitimate public purpose. *Dandridge v. Williams,* 397 U.S. 471, 484-86 (1970).

A. The Challenged Classification Rationally Relates To A Legitimate Public Purpose.

This test for equal protection in the context of economic regulation is clearly set forth in *New Orleans v. Dukes,* 427 U.S. 297 (1976). That case challenged an ordinance of the City of New Orleans which prohibited pushcart vendors while grandfathering in those vendors who had been in business for more than eight years. The challenge was brought by a pushcart vendor who had been in business for two years. This Court stated:

> When local economic regulation is challenged solely as violating the Equal Protection Clause, this Court consistently defers to legislative determinations as to the desirability of particular statutory discriminations. [Citations] Unless a classification trammels fundamental personal rights or is drawn upon inherently suspect distinctions such as race, religion, or alienage, our decisions presume the constitutionality of the statutory discriminations and require only that the classification challenged be rationally related to a legitimate state interest. States are accorded wide latitude in the regulation of their local economies under their police powers, and rational distinctions may be made with substantially less than mathematical exactitude.

Id. at 303.

Social and economic enactments carry a strong presumption of rationality that can be overcome only by a clear showing of arbitrariness or irrationality. The burden is on the party raising the challenge. *Hodel v. Indiana,* 452 U.S. 314, 331-32 (1981). If there is any conceivable relationship between a proper goal and the means, neither overinclusiveness nor underinclusiveness is fatal to the classification and the existence of a better method of achieving the goal is irrelevant. *Vance v. Bradley,* 440 U.S. 93, 108 (1979).

Appellants cite to a series of California cases dealing with the care of the mentally ill including *In re Jerald C.,* 36 Cal. 3d 1, 678 P.2d 917, 201 Cal. Rptr. 342 (1984), and *Department of Mental Hygiene v. Hawley,* 59 Cal. 2d 247, 379 P.2d 22, 28 Cal. Rptr. 718 (1963). Brief of Appellants at 19. As the California Supreme Court pointed out in *Pennell v. City of San Jose,* 42 Cal. 3d at 372, 721 P.2d at 1116, 228 Cal. Rptr. at 731, these cases are completely inapposite. These cases, according to the court that decided them, stand for the narrow principle that equal protection does not permit government to impose upon relatives the cost of protecting society from persons who must be confined in institutions. These cases do not stand for the broad principle, urged by Appellants, that shifting economic burdens onto a discrete class of persons is always a subsidy which violates the Constitution. Clearly, it is not. For example, in *Bowen v. Gilliard,* ___ U.S. ___ , 107 S. Ct. 3008 (1987), the Court rejected the argument that the reduction in welfare payments to certain parents, because support was received by their children from non-custodial parents, impermissibly required such children to bear the welfare burden which should be borne by the public at large.

Just as it was constitutionally permissible for Congress to eliminate windfall benefits for certain groups of employees covered by the Railroad Retirement Act of 1974 (45 USC § 231 *et seq.*) without eliminating windfall benefits for all, *United States Railroad Retirement Board v. Fritz*, 449 U.S. 166 (1980), it is constitutionally permissible for San Jose to structure an ordinance which limits the allowed rent increases to landlords with hardship tenants somewhat more than it limits rent increases for landlords with non-hardship tenants.

B. A Rent Control Ordinance Constitutionally May Treat Some Landlords Differently Than Others.

The equal protection argument was specifically discussed in the rent control context by the U.S. Emergency Court of Appeals in *Taylor v. Brown*, 137 F.2d 654 (Emer. Ct. App.), *cert. denied*, 320 U.S. 787 (1943). There the court upheld the power of the administrator "to make classifications and differentiations and to provide for adjustments and reasonable exceptions" in order to effectuate the purposes of the Act. *Id.* at 659. This Court, itself, squarely addressed the issue of equal protection in the context of rent control in *Woods v. Cloyd W. Miller Co.*, 333 U.S. 138 (1948). In that case, an equal protection violation was claimed on the grounds that certain classes of housing were exempted. The Court upheld the Act stating that Congress "need not control all rents or none. It can select those areas or those classes of property where the need seems the greatest." *Id.* at 145. See also *Marcus Brown Holding Co. v. Feldman*, 256 U.S. 170 (1920).

Equal protection does not require that all landlords of multifamily housing be treated identically. Rent control legislation has been held not violative of equal protection despite distinctions between landlords who perfect successful tax appeals and those who do not. *Gateway Apartments v. Nutley Township*, 605 F. Supp. 1161 (D.N.J. 1985); *Cold Indian Springs Corp. v. Township of Ocean*, 154 N.J. Super. 75, 380 A.2d 1178 (1977). Distinctions between landlords of luxury apartments and non-luxury apartments are permissible. *Gauthier v. Gabel*, 44 Misc. 2d 887, 255 N.Y.S.2d 200 (1964), *aff'd*, 16 N.Y.2d 720, 209 N.E.2d 733, 262 N.Y.S.2d 105 (1965). Similiarly, landlords with long term tenants may be treated differently than landlords with short term tenants, and landlords with elderly and disabled tenants may be treated differently than landlords without those classes of tenants. *Vitaliotis v. Mossesso*, 130 Misc. 2d 141, 495 N.Y.S.2d 111 (N.Y. Civ. Ct. 1985). Distinctions between landlords with two- and three-family dwellings and other multi-family landlords are not unreasonable irrespective of whether rent control is applied only to the former or only to the latter. *Marshal House, Inc. v. Rent Control Board*, 358 Mass. 686, 266 N.E.2d 876 (1971).

The San Jose City Council very reasonably concluded that the tenant hardship provision would directly promote the legitimate public purpose of housing stability by imposing a somewhat greater limitation on the rent increases allowed to those landlords whose tenants were most likely to be displaced by excessive rents. It is certainly rational to prevent landlords from maximizing their exploitation of the local housing shortage at the expense of those tenants who cannot afford to pay increases. Therefore, the challenged classification clearly does not deny Appellants equal protection of the law.

CONCLUSION

For the reasons stated above, this Court should dismiss this appeal or affirm the decision of the California Supreme Court.

Dated: July 31, 1987

JOAN R. GALLO*
CITY ATTORNEY
GEORGE RIOS
ASSISTANT CITY ATTORNEY

* Counsel of Record

APPENDIX A

17.23.440 Standards of Reasonableness to be Applied to Rent Increases.

Hearing officers shall determine whether rent increases are reasonable under the circumstances, taking into consideration that the purpose of this chapter is to permit landlords a fair and reasonable return on the value of their property while protecting tenants from arbitrary, capricious or unreasonable rent increases, and under certain circumstances, unjustified economic hardship. The hearing officer's determination shall be made with reference to the following standards:

A. **Increase Deemed Reasonable.** Where the amount of the proposed rental increase consists only of passing through one or more of the following:

1. Costs of capital improvements;
2. Increased costs of maintenance and operation; or
3. Costs or rehabilitation; plus no more than five percent of the monthly rent, they shall be deemed reasonable, and the hearing officer shall allow the entire rental increase provided that:

    a. Cost figures have been established to his reasonable satisfaction;

    b. The costs of capital improvements if any are averaged on a per unit basis and are amortized over a period not less than sixty months;

    c. The costs of rehabilitation if any are averaged on a per unit basis and are amortized over a period not less than thirty-six months;

    d. Each of the costs proposed to be passed through to tenants, whether it be costs of capital improvements, increased costs of operation and maintenance, or costs of rehabilitation, bears a reasonable relationship to the purposes for which such costs were incurred and the value of the real property to which they are applied.

B. When Costs of Debt Service Deemed to be Reasonable. For purposes of this subsection, loan-to-value ratio (LV) shall mean the aggregate amount of debt divided by a lender's appraised value of the property, and factor shall mean the percentage of increased debt service cost. Increased costs of debt service shall be deemed reasonable and allowed by the hearing officer if the LV is seventy percent or less and no more than eighty percent of the cost of such debt service is being passed through to the tenants. If the LV is greater than seventy percent, the increased costs of debt service arising from that proportion of the aggregate amount of debt not exceeding seventy percent of the value of the property shall be deemed reasonable and allowed by the hearing officer to be passed through to tenants pursuant to the following LV factor schedule:

LV	Factor
71	79.5%
72	79.0%
73	78.5%
74	78.0%
75	77.5%
76	76.5%
77	75.7%
78	74.5%
79	73.5%
80	72.5%
81	71.5%
82	70.5%
83	69.5%
84	68.5%
85	67.5%
86	66.5%
87	65.5%
88	64.5%
89	63.5%
90	62.5%
91	61.5%
92	60.5%
93	59.5%
94	58.5%
95	57.5%
96	56.0%
97	54.5%
98	53.0%
99	51.5%
100	0.0%

Where no lender's appraisal is available the hearing officer may secure such appraisal to be paid for by the landlords as a cost of maintenance and operation.

C. Standards Applicable to Rent Increases Which Exceed the Foregoing. In order to assure to landlords a fair and reasonable return on the value of their property, the hearing officer shall, when the amount of any rent increase or portion thereof exceeds any of the foregoing standards under subsection A or B of this section, determine what is reasonable under the circumstances, taking into account any of the following factors on which he has received information:

1. In the case of increased costs of debt service due to a sale or refinancing of the rental units or the building or property of which the units are a part within twelve months of the increase:

   - a. The arm's-length nature of the transaction;
   - b. The landlord's rate of return on the investment;
   - c. The frequency of past resale or refinances;
   - d. The extent to which prior rental increases have made provisions for appreciation of asset value.

2. The rental history of the unit or the complex of which it is a part, including:
   - a. The presence or absence of past increases;
   - b. The frequency of past rent increases;
   - c. The landlord's response to Proposition 13 savings;
   - d. The occupancy rate of the complex in comparison to comparable units in the same general area.
3. The physical condition of the rental unit or complex of which it is a part including the quantity and quality of maintenance and repairs performed during the last twelve months.
4. Any increases or reduction of housing services during the last twelve months before the effective date of the proposed rent increase.
5. Other financial information which the landlord is willing to provide.
6. Existing market value of rents for units similarly situated.
7. The hardship to a tenant, as provided in Section 17.23.450.

17.23.450 Hardship To Tenants.

In the case of a rent increase or any portion thereof which exceeds the standards set in Section 17.23.440A or B, then with respect to such excess and whether or not to allow same to be part of the increase allowed under this chapter, the hearing officer shall consider the economic and financial hardship imposed on the present tenant or tenants of the unit or units to which such increases apply. If, on balance, the hearing officer determines that the proposed increase constitutes an unreasonably severe financial or economic hardship on a particular tenant, he may order that the excess of the increase which is subject to consideration under paragraph C of Section 17.23.440, or any portion thereof, be disallowed. Any tenant whose household income and monthly housing expense meet the criteria established by the Housing Assistance Payments Program under Section 8, existing housing provisions of the Housing and Community Development Act of 1974 (P.L. 93-383) and the regulations pertaining thereto, shall be deemed to be suffering under financial and economic hardship which must be weighed in the hearing officer's determination. The burden of proof in establishing any other economic hardship shall be on the tenant.

APPENDIX B

RESOLUTION NO. 59907

A RESOLUTION OF THE COUNCIL OF THE CITY OF SAN JOSE CLARIFYING THE MEANING AND INTENT OF ITS RENTAL DISPUTE MEDIATION AND ARBITRATION ORDINANCE

WHEREAS, in 1979, the City of San Jose enacted the San Jose Rental Dispute Mediation and Arbitration Ordinance; and

WHEREAS, Section 5703.28(c) of said Ordinance, now codified as Section 17.23.440(c) of the San Jose Municipal Code establishes tenant hardship as a possible factor to be weighed in determining a reasonable rent increase; and

WHEREAS, this provision has been misconstrued by certain members of the public and such misconstruction has been nationally publicized; and

WHEREAS, this provision is the subject of litigation now pending before the United States Supreme Court; and

WHEREAS, in the pending litigation, the National Association of Home Builders and the California Building Industry Association, in a brief filed as amici curiae in opposition to the Ordinance, expressed a need for clarification; and

WHEREAS, the City Council desires to correct all misunderstandings about the application of the tenant hardship factor to any rent increase proposed under the Ordinance.

NOW, THEREFORE, BE IT RESOLVED BY THE COUNCIL OF THE CITY OF SAN JOSE

SECTION 1. The San Jose Rental Dispute Mediation and Arbitration Ordinance is intended to ensure that landlords receive a fair and reasonable return on the value of their property.

In addition to ensuring landlords a fair return on the value of their property, the Ordinance provides a mechanism for a Hearing Officer to determine the amount of a proposed rental increase which is "reasonable under the circumstances."

In enacting Section 5703.28(c) of said Ordinance, now codified at Section 17.23.440(c) of the San Jose Municipal Code, the City Council understood that there were a number of ways to calculate the fair return to a landlord and that while fair return on the value of property should serve as the minimum return under the Ordinance, a greater return may be fair and reasonable under some circumstances.

SECTION 2. The City Council finds and declares:

1. A rental increase which is less than that necessary to provide a fair return on value of the property is never deemed to be fair and reasonable rental increase for purposes of this Ordinance.
2. A rental increase which is greater than that necessary to provide a fair return on the value of property may well be reasonable under the circumstances, and provided that it is not excessive, such a rental increase may be allowed by a Hearing Officer.
3. Subsection (c) of Section 17.23.440 (formerly 5703.28) is intended to allow the Hearing Officer to weigh and balance all factors including tenant hardship in determining what increment, if any, of rental increase greater than necessary to provide a fair return on the value of the property is fair and reasonable under the circumstances without being excessive.

SECTION 3. This resolution is intended merely as a clarification. At no time was the San Jose Rental Dispute Mediation and Arbitration Ordinance ever intended to be otherwise interpreted.

REPLY
BRIEF

Supreme Court, U.S.
FILED
OCT 29 1987
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CLERK

No. 86-753

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1986

RICHARD PENNELL and
TRI-COUNTY APARTMENT HOUSE OWNERS ASSOCIATION,
Appellants,

vs.

CITY OF SAN JOSE and CITY COUNCIL OF
THE CITY OF SAN JOSE,
Appellees.

**On Appeal from the Supreme Court
of the State of California**

REPLY BRIEF OF APPELLANTS

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13A Wright, Miller & Cooper, Federal Practice and Procedure, p. 87 5

SUMMARY OF ARGUMENT

Appellees argue that any public purpose will justify the challenged provision of the Ordinance as long as landlords are assured a "fair return." Appellants argue that even if a fair return is provided, rent control can only serve the legitimate objective of preventing excessive rents permitted by a housing shortage. While tenant hardship is a proper public concern, it is not a proper consideration in a rent control ordinance which reduces rent based upon the fortuitous circumstance of a tenant's ability to pay, creates a lifetime tenancy, results in imposing public burdens on individuals without corresponding benefits, and transfers private property from one individual to another.

ARGUMENT

I

THIS CASE IS JUSTICIABLE

A. Appellant Tri-County Apartment Owners Association Has Standing to Bring This Action

Appellees contend that Appellant Tri-County Apartment Owners Association ("TCAA") does not meet the three prong standing test of *International Union v. Brock*. Appellees' Brief, p. 9. They contend that TCAA does not meet the first two prongs of this test solely because the complaint was verified by counsel and not by Appellants.[1] However, where standing is challenged on the basis of the pleadings, all material allegations of the complaint are accepted as true and the complaint is construed in favor of the complaining party.[2]

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[1] Assuming, arguendo, that the judgment on the pleadings rendered by the California Superior Court requires a complaint verified by a party, the lack of party verified pleadings is *not* a jurisdictional defect, *Estate of Coner* 227 Cal.App.2d 157, 159 (1964); *In Re Staser* 84 Cal.App.2d 746, 751-752 (1948); and, not having raised this issue at any time in this action, under California law Appellees have waived their right to object to the want of verification. *Security Trust & Savings Bank v. Fidelity & Deposit Co.*, 184 Cal. 173, 176, 177 (1920).

[2] *Gladstone v. Bellwood*, 441 U.S. 91, 109 (1978); *Warth v. Seldin*, 442 U.S. 490, 501 (1975); *Jenkins v. McKeithen*, 395 U.S. 411, 421-422

TCAA meets the first prong of the *International Union* standing test because its members would have (and Appellant Richard Pennell has) standing to bring this action individually. Individual standing requires: (1) actual or threatened injury; (2) which is traceable to the challenged action; and (3) is likely to be redressed by a favorable decision. *Valley Forge Christian College v. Americans United For Separation of Church and State, Inc.*, 454 U.S. 464, 472 (1982); *National Motor Freight Traf. Assn. v. United States*, 372 U.S. 246, 247 (1963).

In order to demonstrate threatened injury, one need not await consummation of the injury to obtain preventative relief, *Babbitt v. United Farm Workers Nat. Union*, 442 U.S. 289, 298 (1979), and where the inevitability of the operation of a statute against certain individuals is patent, it is not relevant that there is a delay before the disputed provisions are applied. *Blanchette v. Connecticut General Insurance Corp.*, 419 U.S. 102, 143 (1974); *Cedar Rapids Gas Light Co. v. City of Cedar Rapids*, 223 U.S. 655, 666-667 (1912).

The challenged tenant hardship provision of the Ordinance will be enforced solely against TCAA's members, the owners and lessors of residential rental property in San Jose. J.A. 3. This is not a hypothetical, conjectural or abstract injury because there is no one else against whom the Ordinance can be enforced.[3] The challenged portion of the Ordinance threatens TCAA's members with concrete and tangible economic injury (by way of reduced rents and property values), constitutional injury (deprivation of property, denial of equal protection and due process) and civil and criminal sanctions for noncompliance. Since constitutional application of the challenged provision is impossible, Appellants' Brief, pp 10-11, the injuries are certain unless the challenged provision

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(1969). See, *First English Evangelical Lutheran Church of Glendale v. County of Los Angeles*, 107 S.Ct. 2378, 2384-2385 (1987).

[3] Amicus City of San Monica claims that Appellants must allege that they rent to tenants who will avail themselves of the challenged provision of the Ordinance and that they have been denied or are likely to be denied rental increases. (Amicus Brief, City of Santa Monica, p.9, n. 19). This claim is without case citation, and is unsupported by the justiciability case law. Appellants have made the necessary showings for justiciability.

is never applied. No additional facts, inquiries or investigations are necessary to establish the direct reality of the controversy. In fact, this Court routinely rules on associational and individual facial taking challenges, and impliedly finds standing, without any application of the challenged regulation.[4]

TCAA members meet the remaining individual standing requirements because the injuries which will be suffered by TCAA's members are traceable directly to the application and enforcement of the challenged provision, and the threat of the injuries will be redressed and removed by the injunction and declaration sought in this action.

TCAA meets the second prong of the *International Union* standing test because it seeks to protect lessors in the City of San Jose from suffering the imposition of an unconstitutional rent control provision, an action which is germane to TCAA's stated purpose of representing the interests of owners and lessors of real property in San Jose. J. A. 3.

TCAA meets the third prong of the standing test because the facial challenge at bar is a pure question of law, requiring no participation whatsoever from individual members, and the remedies sought, injunctive and declaratory relief, are the classic remedies sought in associational cases.[5]

B. Appellant Richard Pennell Owns Property Subject to the Ordinance, and Therefore Has Standing in This Case

As stated in the declaration filed in this case, Appellant Richard Pennell did sell his real property, but has re-acquired an apartment building in San Jose which is subject to the Ordinance, and which he owns at the present time. As such, Pennell has the personal stake and exposure to injury necessary to establish his standing to bring this action as an individual, and this case is not moot as to him.

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[4] See, e.g., *Keystone Bituminous Coal Assn. v. Debenedictis*, 107 S.Ct. 1232, 1238 (1987); *Hodel v. Indiana*, 452 U.S. 314, 334 (1981); *Hodel v. Virginia Surface Mining*, 452 U.S. 264, 294-297 (1981).

[5] *Hunt v. Washington State Apple Advertising Comm'n*, 432 U.S. 333, 342-343 (1978); *Warth v. Seldin*, 422 U.S. 490, 515 (1975) (associational standing is often based upon the relief sought); *Olagues v. Russoniello*, 770 F.2d 791, 797-799 (9th Cir. 1985).

C. This Case Is Ripe for Review as a Facial Challenge

Appellees and their Amici contend that the facial challenge in this case is not ripe for review because the challenged provison of the Ordinance has not been applied by local authorities.[6]

A facial challenge does not require individual, "ad hoc'" factual applications of the challenged regulation.[7]

The controversy at bar has the same ripeness characteristics of immediacy, certainty and reality as the numerous facial taking cases that this Court has found to be ripe, without any application of the challenged regulation.[8]

The facial challenges in the cases cited by Appellees failed because the Appellant could not prove a loss of the "economically viable use of the property" without evidence of an ad hoc applicaton of the statute. Appellants do not claim such a loss. Rather, Appellants challenge the tenant hardship provision of the Ordinance because it "does not substantially advance legitimate state interests." This issue can be decided by an examination of the face of the Ordinance without an ad hoc applicaton.[9]

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[6] Brief of Appellees, pp 12-14; Amicus Brief of National Institute of Municipal Law Officers, pp 8-11; Amicus Brief of the City of Santa Monica, pp 8-10, Amicus Brief of National Housing Law Project, pp 19-25.

[7] The cases cited by Appellees regarding due process and equal protection facial challenges also are not applicable. Plaintiff's substantive Due Process claims failed in *Pace Resources not* because of ripeness, but because of pleading defects. 808 F.2d, at 1035. Defendant's Due Process claim failed in *Hodel v. Indiana* because of the failure to show sufficient threat of injury. 452 U.S., at 335-336.

[8] See, e.g., *Keystone Bituminous Coal Association et al. v. Debendictis,* 107 S.Ct. 1232, 1239, (1987); *Hodel v. Indiana,* 452 U.S. 314, 334 (1981); *Hodel v. Virginia Surface Mining and Reclamation Association,* 452 U.S. 264 (1981); *Cedar Rapids Gas Light Co. v. City of Cedar Rapids,* 223 U.S. 655, 666-667 (1912) (16 year delay in enforcing facial challenge).

[9] Each of the decisions referenced by Amici found either expressly or impliedly that the challenged statute substantially advanced legitimate state interests. In *Zobel v. Williams,* 457 U.S. 55, 60-63 (1982), the

Appellees suggest that it would be advisable to wait until the tenant hardship provisions are actually applied because factual disputes or administrative action may avoid a taking. Appellees' Brief, pp 12-13. The actual method of applying the challenged provisions is immaterial in this case because the provision is not capable of *any* constitutional application whatsoever. Appellants' Brief, pp 10-11.

D. Public Policy Favors a Finding of Justiciability

To the extent the standing issues raised by Appellees are based upon prudential limitations on justiciability as opposed to constitutional limitations,[10] this Court should find this action justiciable for public policy reasons.

A dismissal of this appeal without a decision on the merits would confirm the decision of the California Supreme Court, would allow other municipalities to add tenant hardship provisions to their rent control laws, would produce further repetitive and time consuming litigation, see, e.g., *Craig v. Boren,* 429 U.S. 190, 193-194 (1976), and would create uncertainty on an important federal question. See, 13A Wright, Miller & Cooper, Federal Practice And Procedure, p. 87. There is nothing to be gained by way of a factual record or individual application of the challenged portion of the Ordinance which would assist this Court in deciding the constitutional issues at stake.

If the challenged provision of the Ordinance is invalid as an unconstitutional taking, its application will inflict monetary damage upon property owners, for which Appellees will be liable. *First English Evangelical Luthern Church of Glendale v. County of Los Angeles,* 107 S.Ct. 2378, 2388 (1987). These damages will be avoided by reaching the constitutional merits in this case.[11] Also, a denial of a facial challenge by associational representation will leave individual property owners with no practical forum for redress.[12]

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court confirmed a facial challenge because the statute did *not* rationally serve a legitimate state interest.

[10] See, e.g., *Flast v. Cohen,* 392 U.S. 83, 94-97 (1968).

[11] Appellees have not implemented the challenged provision of the Ordinance until constitutionality is determined. Appellees' Brief, p. 5.

[12] See, Jurisdictional Statement, p. 12, n. 11.

II

EVEN ASSUMING THAT THE ORDINANCE ASSURES A FAIR RETURN, IT VIOLATES THE FOURTEENTH AMENDMENT BY EFFECTING AN UNCOMPENSATED TAKING OF PRIVATE PROPERTY

A. Even if Landlords Receive a "Fair Return", the Test of Whether There Has Been a "Taking" Requires a Consideration of Several Additional Questions

Appellants and their Amici have shown how the operation of the tenant hardship provision of the Ordinance *by its express terms* denies landlords the required "fair and reasonable" return.[13] However, even assuming that landlords receive a "fair return," the Ordinance violates the Just Compensation clause.

By the terms of the Ordinance, the fourth method of calculating the allowable rent increase is only relevant when the first three methods do not provide a "fair return." The administrator determines that the new rent will be "reasonable" based upon the landlord's costs, but that rent is reduced based upon an individual tenant's ability to pay. This reduction constitutes a "taking."

Appellees[14] and their Amici argue that any price regulation is valid if it assures a "fair return" and has any public objective. This approach fails to recognize that the exercise of the police power violates the Fourteenth Amendment when it goes "too far."[15]

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[13] See Appellants' Brief, pp 8-11; Brief Amicus Curiae Of The National Apartment Association, et al., pp 18-19; Brief Amici Curiae For Rent Stabilization Association Of New York City, Inc., et al., pp 7-9; Brief Of The National Association Of Home Builders, et al., pp 8-15; Brief of Amicus Curiae National Association Of Realtors, pp 11-13.

[14] See Appellees' brief, pp 18-23.

[15] *First English Evangelical Lutheran Church of Glendale v. County of Los Angeles*, 107 S.Ct. 2378, 2386, 2393 (1987) (Stevens, J. dissenting); *Williamson County Regional Planning Commission v. Hamilton Bank of Johnson City*, 473 U.S. 172, 186 (1985); *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415-416 (1922); *Block v. Hirsh*, 256 U.S. 135, 156 (1921). See, Brief of the National Multi Housing Council, p. 23.

The test of whether a police power regulation goes "too far" is a two part test *in the alternative*. An ordinance effects an uncompensated "taking" if it "does not substantially advance legitimate state interests" *or* if it "denies an owner economically viable use of his land."[16] This test is applied by examining several factors, and the three factors of "particular significance" are (1) the economic impact of the regulation on the claimant, (2) the extent which the regulation has interfered with distinct investment backed expectations, and (3) the character of the government action. Appellees' Brief, pp 18-19. The Ordinance fails these tests.

The *economic impact* of the Ordinance is to deprive landlords of rent otherwise deemed reasonable solely because of the tenant's inability to pay. See page 6, *supra*.

Even if it is assumed that landlords could anticipate a general rent control ordinance, their *investment backed expectations* are frustrated by the additional burden of the unanticipated further reduction in rent because of a tenant's inability to pay and the creation of a permanent, lifetime tenancy.[17]

The *character of the government action* accomplishes a transfer of landlords' property to individual hardship tenants, see pages 14-

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[16] *Nollan v. California Coastal Comm.*, 107 S.Ct. 3141, 3146-3147 (1987); *Keystone Bituminous Coal Assn. v. Debenedictis*, 107 S.Ct. 1232, 1242 (1987); *United States v. Riverside Bayview Homes, Inc., 474 U.S. 121, 126 (1985)*; *Agins v. City of Tiburon*, 447 U.S. 255, 260 (1980). See also, *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 127 (1978); *Thompson v. Consolidated Gas Utilities Corp.*, 300 U.S. 55, 68-70, 79-80 (1937).

This test is applied to economic regulation between landlord and tenant. *Federal Communications Comm. v. Florida Power Corp.*, 107 S.Ct. 1107, 1112.

[17] See Appellants' Brief, p 26.

Upon construction or acquisition of an apartment building, pre-Ordinance landlords received building permits and/or certificates of occupancy that permitted rental of property without restriction on the amount that could be charged. The subsequent imposition of a "tenant hardship" limitation on rents frustrates these expectations created in reliance upon the government permit. *See*, e.g., *Kaiser Aetna v. United States*, 444 U.S. 164, 179-180 (1979).

15, *infra*, and imposes a public burden on landlords that should be borne by the community at large. See pages 10-14, *infra*. In doing so, the Ordinance "does not substantially advance legitimate state interests." See pages 8-10, *infra*.

B. The Tenant Hardship Provision Is Not Rationally Related to the Only Legitimate Purpose for Rent Control

Appellees justify the Ordinance by its objectives of (1) the "prevention of excessive and unreasonable rent increases caused by the growing shortage of and increasing demand for housing,"[18](2) "the alleviation of undue hardships upon individual tenants,"[19] and (3) the protection of tenants from involuntary displacement.[20] While the first objective is legitimate, the other objectives are not rationally related to the legitimate purpose of a rent control ordinance. The only rationally related purpose of rent control is to correct a non-competitive market, and any other purpose invalidly imposes a public burden on private parties.

In circumstances where the price of goods is not established by a freely competitive marketplace, government has a legitimate interest in protecting consumers from artificially inflated prices, and in preventing suppliers from exploiting consumers by receiving windfalls from fortuitous disruptions of the natural laws of supply and demand. Thus, when a supplier has a monopoly or

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[18] Ordinance, Section 5701.2.

[19] Ordinance, Section 5701.2.

[20] Appellee's Brief, pp 15-18, 23-25. Assuming that this is a legitimate public purpose, see pp 10-11, infra, Appellees thereby open the issue of the validity of the eviction restrictions in the Ordinance. Because of the permanence of the regulation (an issue that has been left open by this Court for future resolution), the Ordinance in effect *creates a life tenancy, a possessory* estate, which is a *per se* "taking" without regard to justification. See *Fresh Pond Shopping Center v. Callahan*, 464 U.S. 875, 878 (1983) (Rehnquist, J. dissenting); Brief of the National Multi Housing Council, pp 21, 25-28; Brief Amici Curiae for Rent Stabilization Association of New York City, Inc., et al., pp 9-11; Brief of Appellants, pp 28-30; Brief of the National Multi Housing Council, pp 25-28; Brief Amici Curiae for Rent Stabilization Association of New York City, Inc., et al, pp 9-11. Compare *Federal Communications Comm. v. Florida Power Corp.*, 107 S.Ct. 1107, 1112 (1987).

near monopoly, such as a public utility,[21] or when demand is insufficient in relation to supply,[22] or when supply is insufficient in relation to demand,[23] government can regulate prices to a level that would approximate the prices established by normal operating market forces. There is a rational relationship between the regulation and the legitimate government objective of protecting the public from the hardship resulting from unique market conditions.

Rent control can only be justified because of such unique, unbalanced market conditions.[24] Price regulation that reduces prices below the equilibrium level produced by a freely competitive market no longer serves this objective;[25] rather it is designed for a broader social purpose of subsidizing the consumer by providing goods at below market prices.[26]

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[21] *Federal Communications Comm. v. Florida Power Corp.*, 107 S.Ct. 1107, 1110 (1987); *Federal Power Commission v. Texaco*, 417 U.S. 380, 397-398 (1974); *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 792-793 (1968); *Federal Power Comm. v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1943); *Federal Power Comm. v. Natural Gas Pipeline*, 315 U.S. 575, 585 (1942).

[22] *Nebbia v. New York*, 291 U.S. 502, 530, 538 (1987); *Sunshine Anthracite Coal Co. v. Adkins*, 310 U.S. 381, 395-396 (1940); *U.S. v. Rock Royal*, 307 U.S. 533, 549-550, 569-570 (1939); *Bordens Farm Products Co., Inc. v. Ten Eyck*, 297 U.S. 251, 257-259, 261 (1936).

[23] *Woods v. Clyde W. Miller Co.*, 333 U.S. 138, 142 (1948); *Bowles v. Willingham*, 321 U.S. 503, 513-514 (1944); *Yakus v. United States*, 321 U.S. 414, 422-423 (1944).

[24] See Brief of Amici Curiae The Washington Legal Foundation, et al, pp 14-16.

"And this court has definitely said that the production or sale or food or clothing cannot be subjected to legislative regulation on the basis of a public use; and that the same is true in respect of the business of renting houses and apartments, except as to temporary measures to tide over grave emergencies." *New State Ice Co. v. Liebmann*, 285 U.S. 262, 277 (1932).

[25] If the Ordinance lowers rents more than is required to meet the legitimate objectives of the ordinance, it is confiscatory and invalid. *The Chastleton Corp. v. Sinclair*, 264 U.S. 543, 548 (1924) ("If about all that remains of war conditions is the increased cost of living, that is not in itself a justification of the act.")

C. The "Tenant Hardship" Provision of the Ordinance Improperly Imposes a Public Burden on Individual Landlords That Should Be Borne by the Community At Large

The issue of the proper limits of rent control is exaggerated when rents are reduced for an individual tenant who cannot afford to pay the rent which is otherwise deemed "reasonable." The tenant hardship provision of the Ordinance is not directed to the general problem of exorbitant rents caused by a shortage of housing supply. While the other provisions of the Ordinance are directed towards the legitimate public objective of precluding a landlord from charging rents which are excessive and *unreasonable* because of an inadequate housing supply, the tenant hardship provision is directed to the objective of protecting the individual tenant from the payment of *reasonable* rents.

Appellees and their Amici justify the tenant hardship provisions by the need to provide affordable housing to the poor and to prevent displacement of poor tenants because of their inability to pay rent.[27] These are proper government interests, but a rent control ordinance is not the proper means to achieve these objectives. To the extent that these objectives are served by a rent control ordinance that reduces the general rent levels to those that would be produced in a normal market with adequate supply, the Ordinance serves a proper purpose. However, to the extent that rents are further reduced because of an individual tenant's inability to pay, there is no rational connection between the regulation and a proper objective of rent control.[28]

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[26] See, e.g., *Williams v. Standard Oil Co. v. Louisiana*, 278 U.S. 235, 240 (1928) (invalidating state law fixing retail gasoline prices); *Fairmont Creamery Co. v. Minnesota*, 274 U.S. 1, 9 (1927) (invalidating regulation requiring payment of common price regardless of purchase location).

[27] See Appellees' Brief, pp 14-18; Amicus Brief of the City of Santa Monica, pp 14-25; Amicus Brief for the American Civil Liberties Union, et al., pp 15-20.

[28] See, Brief of the National Multi Housing Council, pp 17-21; Brief amicus curiae of the National Apartment Association, pp 20-21; Brief

The state has the obligation to provide housing for the underprivileged. This is a duty of the public, of all citizens, including the owners of commercial or industrial property, the owners of private residences, and those citizens who do not own property;[29] it is not a proper objective of rent control that only burdens the small number of persons who own residential rental property and rent to hardship tenants, without a corresponding individual benefit.[30]

Numerous federal and state laws recognize that it is a uniquely public function to provide housing subsidies for those suffering financial hardship.[31] The public duty to provide housing to the underprivileged must be satisfied by the use of public funds and not selected private resources. Rather than providing such a subsidy itself, the city has, *in effect,* surcharged landlords by reducing the rent that would otherwise be charged *by the city's own determination* of "reasonableness," and transferring the reduction to the hardship tenant.[32] Landlords thereby relieve the city of its public duty to support poor tenants by a forced subsidy

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Amici Curiae For Rent Stabilization Association of New York City, Inc., et al, pp 11-15.

[29] See Brief of Amicus Curiae California Association of Realtors, pp 18-20

[30] See Brief of Appellants, pp 23-29; Brief Amici Curiae of the National Apartment Association, et al., pp 16-27; Brief Amici Curiae for Rent Stabilization Association of New York City, Inc., et al., pp 11-15; Brief Amicus Curiae National Association of Realtors, pp 19-21; Brief of the National Multi Housing Council, pp 22-24; Brief Amicus Curiae of the Washington legal Foundation, pp 3-6; Brief Amicus Curiae of the the California Association of Realtors, pp 15-22; Brief Amicus Curiae of the Competitive Enterprise Institute, pp 3-4.

[31] See Brief Amicus Curiae of the National Apartment Assn., et al., pp 24-25; Brief Amicus Curiae of the California Association of Realtors, pp 18-22.

Existing laws that provide for a *supply* of low income housing are based upon a "reciprocity of advantage; by *voluntary* regulations that provide the owner low interest loans (see, e.g., 42 U.S.C. §§ 1437b), or increased density (see, e.g., Cal. Govt. Code §§ 65915, 65915.5).

[32] See Jurisdictional Statement, pp. 8-9.

from landlords to tenants.[33] It is as if the city imposed the financial burden of police or fire protection on a limited number of rental property owners, thereby relieving other citizens of the financial obligation for such services. Such "government actions that may be characterized as acquisitions of resources to permit or facilitate uniquely public functions have often been held to constitute 'takings.'" *Penn Central Transportation Company v. City of New York*, 438 U.S. 104, 128 (1978).[34]

Also, since the low-income subsidies payable by the federal government are based upon a tenant's income and the amount of rent he has to pay, see 42 U.S.C. §§ 1437(A)(f), to the extent that landlords are forced to reduce rent to hardship tenants the amount of *federal* subsidies are reduced accordingly.

The Ordinance thus imposes on those landlords who rent to hardship tenants the burden that in all fairness should be borne by the public at large.[35] The assistance of the poor in providing

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[33] See, Brief of National Multi Housing Council, pp 19-20.

[34] See. Jurisdictional Statement, pp 7-10; Brief of Appellants, pp 23-26; Brief Amicus Curiae of the National Apartment Assn., pp 16-27.

[35] "The Fifth Amendment's guarantee that private property shall not be taken for a public use without just compensation was designed to bar government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Armstrong v. United States*, 364 U.S. 40, 49 (1960). See also, *Kirby Forest Industries v. United States*, 467 U.S. 1, 14 (1984); *Agins v. City of Tiburon*, 447 U.S. 255, 260-261 (1980); *San Diego Gas & Elec. Co.*, 450 U.S. 621, 656 (Brennan, J. dissenting).

"The determination that government action constitutes a taking is, in essence, a determination that the public at large, rather than a single owner, must bear the burden of an exercise of state power in the public interest." *Agins v. City of Tiburon*, 447 U.S. 255, 260 (1980). The Fifth Amendment "... prevents the public from loading upon one individual more than his just share of the burdens of government, and says that when he surrenders to the public something more and different from that which is exacted from other members of the public, a full and just equivalent shall be returned to him.' ' *Monongahela Navigation Co. v. United States*, 148 U.S. 3112, 325 (1893). See also, *Keytstone Bituminous Coal Assn. v. Debenedictis*, 107 S. Ct. 1232, 1256 (1987) (Rehnquist, J. dissenting); *Pruneyard Shopping Center v. Robins*, 447 U.S. 74, 83 n. 7 (1980).

housing and food is an obligation of government, and not individual landlords who have no greater duty, and who receive no greater benefit, than any other citizen in the community. The mere desire to improve public conditions or to satisfy a public need is not sufficient justification for a taking of private property without compensation.[36]

The most recent example of this principle is provided by *Nollan v. California Coastal Comm.*, 107 S.Ct. 3141 (1987). Certainly, the acquisition of the beach front easement in *Nollan* was a legitimate public objective, just as providing housing at a reduced cost to the poor is a legitimate public objective. Also, the government could regulate the size, height, and location of Nollan's new home to preserve the public view, because there is a rational relationship between the construction of the home and the obstruction of the public view. Similarly, government can regulate the level of rents to the extent that they are excessively high because of the breakdown of the normal laws of supply and demand.

However, in *Nollan* the government could not require the dedication of a public easement across Nollan's property because there was no rational relation between the construction of his home and the public's need for an easement.[37] The construction of the Nollan home did not cause, nor did it exaggerate, the need for the easement. Similarly, the landlords of San Jose do not cause tenants' poverty, and as long as general rent levels in San Jose are reduced to normal market levels, landlords do not exaggerate the need for low cost housing. See *Nollan v. California Coastal Comm.*, 107 S.Ct. 3141, 3147 n. 4 (1987).[38]

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[36] *First English Evangelical Lutheran Church v. Los Angeles County*, 107 S.Ct. 2378, 2389 (1987); *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 416 (1922); *Keystone Bituminous Coal Ass. v. Debenedictis*, 107 S.Ct. 1232, 1256 (1987) (Rehnquist, J. dissenting). See Brief of Amici Curiae The Washington Legal Foundation, et al, pp 7-8.

[37] As indicated by the dissent in *Nollan*, the need for a rational relationship between the regulation and its objectives is more critical when the action by the government is unilateral as in this case. See 107 S.Ct. 3141, 3155 (Brennan, J. dissenting).

[38] Appellees rely heavily on *Connolly v. Pension Benefit Guaranty Corp.*, 106 S.Ct. 1018 (1986). See Appellee's Brief, pp 21-22. However,

D. The "Tenant Hardship" Provision Is Private Benefit Legislation That Effects a Transfer of Property from One Individual to Another Individual Prohibited by the Fourteenth Amendment[39]

One person's property may not be taken for the benefit of another private person without a justifying public purpose, [40] and when there is a justifying public purpose compensation must be paid.[41]

The distinction between a valid exercise of the police power of general application reasonably related to a proper public purpose, such as a general rent control ordinance, and an invalid regulation enacted solely for the benefit of private parties, such as the tenant hardship provision, is exemplified by a comparison of *Pennsylvania Coal Co. v. Mahon,* 260 U.S. 393, with *Keystone Bituminous Coal Assn. v. Debenedictis,* 107 S.Ct. 1232 (1987).

In *Keystone,* a state law required all mining operators to provide surface support regardless of who owned the surface. The

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the effects of that decision are the opposite of the effects of the Ordinance. In *Connolly* an employer was required to fund the unfunded benefits of *its* employees' pension fund. If it did not do so, it would become a government obligation. Thus, *Connolly* required the employer to satisfy *its* own obligation to avoid the burden *on the public* from funding the *employer's* obligation. The Ordinance requires the landlord to subsidize hardship tenants to relieve the *government* of *its* obligation.

[39] When the rent otherwise deemed "reasonable" is reduced for the hardship tenant, the *effect* of the reduction is to take a portion of the rent which the landlord otherwise could receive and to transfer that amount to the hardship tenant. See Brief Amici Curiae for Rent Stabilization Association of New York City, Inc., et al., pp 8-9; Brief of Amicus Curiae National Association of Realtors, p 14.

[40] *Thompson v. Consolidated Gas Corp.,* 300 U.S. 55, 80 (1937). See also, *Keystone Bituminous Coal Assn. v. Debenedictis,* 107 S.Ct. 1232, 1256 (1987) (Rehnquist, J. dissenting). See Brief of Appellants, pp 26-28; Brief of Amicus Curiae National Association of Realtors, pp 14-18; Brief of Amici Curiae for Rent Stabilization Association of New York City, Inc., et al, pp 6-9.

[41] *Pennsylvania Coal Co. v. Mahon,* 260 U.S. 393, 416 (1922). Also see, *First English Evangelical Lutheran Church v. County of Los Angeles,* 107 S.Ct. 2378, 2389 (1987).

Court held that the law was a valid exercise of the police power because it benefited the general public in preventing the hazards of subsidence, just as a rent control ordinance is a valid exercise of the police power because it benefits the general public by reducing excessive rents to the extent caused by an inadequate supply of housing.

The statute in *Pennsylvania Coal* also required subsurface miners to provide surface support, but it only applied where the surface and the subsurface estates were in different ownership. As such, the statute effected a taking because it provided an individual benefit to surface owners who had lost their right to subjacent support by transferring this right of support from subsurface owners to individual surface owners; it did not provide a public benefit by preventing subsidence in all mining operations. Similarly, the tenant hardship provision only benefits the limited class of poorer tenants by transferring the amount of the rent reduction from landlords to the tenants.

III

THE TENANT HARDSHIP PROVISION IS ARBITRARY, DISCRIMINATORY AND DEMONSTRABLY IRRELEVANT TO PERMISSIBLE LEGISLATIVE POLICY IN VIOLATION OF THE DUE PROCESS CLAUSE

Appellees and their Amici argue that as long as the Ordinance assures a "fair return", and is reasonably related to its stated purposes, the due process clause is satisfied.[42] While the reduction of rent for a hardship tenant serves the stated objective of "the alleviation of undue hardship upon individual tenants,"[43] a due process analysis does not stop there.[44]

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[42] See Appellee's Brief, pp 25-32. Also see, e.g., Brief Amicus Curiae of the Center for Constitutional Rights, pp 29-40; Brief Amicus Curiae of the City of Santa Monica, pp 25-28.

[43] Ordinance, Section 5701.2, Appendix to Jurisdictional Statement, p A-34.

[44] "The only matter that seems open to debate is whether the statute goes too far. For just as there comes a point at which the police power creates and leaves that of eminent domain, it may be conceded that regulations of the present sort pressed to a certain height might amount

Even if landlords receive a "fair return," a due process analysis requires an examination of the government action[45] and a price fixing regulation is not valid if it is not based upon a proper justification.[46] Under the due process clause ". . . maximum rates must be calculated for a regulated class in conformity with the pertinent constitutional limitations. Price control is 'unconstitutional . . . if arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt . . .' "[47] The objective of alleviating individual tenant hardship is arbitrary, unreasonable and discriminatory and not a "policy the legislature is free to adopt" in a rent control ordinance. Appellants' Brief, pp 13-17.[48]

A rent control ordinance can properly reduce rents created by abnormal market conditions to a level that is reasonably related to normal market levels. See pages 9-10, supra. It is unreasonable, however, to further reduce such "reasonable" rents based upon the fortuitous circumstance of the tenant's ability to pay. The regulation is arbitrary and unreasonable because it transfers the landlord's property to individual tenants, see pages 14-15, *supra,* and unfairly imposes a public burden on landlords, see pages 10-14, supra.[49]

The results of the housing shortage are regulated by the other provisions of the Ordinance. Tenant hardship is not created by a housing shortage in San Jose. Rather, the "tenant hardship" provision deals only with the *individual* financial problems of the tenant. The Ordinance seeks to go one step beyond the goals of most rent control ordinances by selecting landlords as one minority group to bear the burdens of individual tenants caused by fortuitous economic circumstances which were not created by landlords. It is arbitrary and unreasonable, and a deprivation of due process, to impose the community's burdens on individual landlords. Appellants' Brief, pp 13-14.

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to a taking without due process of law." *Block v. Hirsh,* 256 U.S. 135, 156 (1921) (re rent control law).

[45] *Pruneyard Shopping Center v. Robins,* 447 U.S. 74, 83 (1980).

[46] See, *Williams v. Standard Oil Co. of Louisiana,* 278 U.S. 235, 240 (1928); *Fairmont Creamery Co. v. Minnesota,* 274 U.S. 1, 9 (1927).

[47] *In re Permian Basin Area Rate Cases,* 390 U.S. 747, 769-770 (1968); *Nebbia v. New York,* 291 U.S. 502, 539 (   ).

[48] Also see, Jurisdictional Statement, pp 10-13; Brief of Appellants, pp 12-19; Brief Amicus Curiae of the National Apartment Association, et al., pp 14-16; Brief Amicus Curiae National Association of Realtors, pp 15-18.

[49] *Property Owners Assn. etc. v. Township of No. Bergen,* 74 N.J. 313, 378 A.2d 25, 27-28, 31 (1977); *Helmsley v. Borough of Fort Lee,* 78 N.J. 200, 394 A..2d 65, 84 (1978).

IV

THE TENANT HARDSHIP PROVISION DEPRIVES LANDLORDS OF EQUAL PROTECTION OF THE LAW

Appellees and supporting Amici base their equal protection argument on two basic propositions: that there is a presumption that the classification is reasonable, and it is reasonable to treat different landlords differently.[50] The reply to this position, and an analysis of the clear violation of the equal protections clause, are presented eloquently and persuasively by Amici in support of Appellants.[51]

In addition, when a regulation designates a limited class to bear its burdens there must be a reasonable relationship between the burdened class and the cause of the problem to be solved. If there is no such relationship the classification is arbitrary and discriminatory.[52]

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[50] See Appellee's Brief, pp 34-37. Also see, e.g., Amicus Curiae Brief for the American Civil Liberties Union, et al., pp 35-40; Brief Amicus Curiae of the City of Santa Monica, pp 28-29.

[51] Brief of National Apartment Association, et. al., pp 6-14, and Brief of National Multi Housing Council, pp 17-21. Also see, Brief Amici Curiae for Rent Stabilization Association of New York City, Inc., pp 11-15; Brief Amicus Curiae of the Competitive Enterprise Institute, pp 12-15.

[52] *Property Owners Assn. etc. v. Township of No. Bergen,* 74 N.J. 313, 378 A.2s 25, 27-28, 31 (1977) (rent control); *Mayflower Farms, Inc. v. Ten Eyck,* 297 U.S. 266, 274 (1936) (price regulation). See *Nollan v. California Coastal Comm.,* 107 S.Ct. 3141, 3147, n. 4 (1987) ("If the [Appellants] were being singled out to bear the burden of California's attempt to remedy these problems, although they had not contributed to it more than other . . . landowners, the State's action, even if otherwise

Landlords are not the cause of the tenants' inability to pay the rent. Rather, landlords have no greater duty than the community in general to assist the underprivileged. The tenant hardship criteria is nothing more than an arbitrary allocation of the community's burden on a select class of landlords who have not in any special way contributed to the need for a tenant's special treatment based solely upon the fortuitous circumstance that a hardship tenant happens to reside in the landlord's property.[53]

The tenant hardship criteria also improperly imposes an unreasonable burden on hardship tenants seeking housing. Landlords as providers of goods have the legal and moral right to consider the consumer's ability to pay, especially when payment is made on an installment basis.[54] By imposing a reduced rent upon landlords who rents to hardship tenants, the Ordinance arbitrarily places the hardship tenant at a disadvantage in the competition for rental housing.[55]

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valid, might violate either the incorporated Takings Clause or the Equal Protection clause."). See Brief of Appellants, pp 19-22.

"One of the essential requirements as to classification, in order that it may not violate the constitutional guarantee as to equal protection of the laws, is that the classification must not be capricious or arbitrary, but must be reasonable and natural, and must have a rational basis, in the light of its purpose and objective." 16A Am. Jur.2d 882-830, Con. Law § 752.

[53] "... we must ... always remember that the equal protection of the laws is guaranteed, and that such equal protection is denied when upon one of two parties engaged in the same kind of business and under the same conditions burdens are cast which are not case upon the other." *Cotting v. Kansas City Stock Yards Co.*, 183 U.S. 79, 112 (1901) (invalidating rate regulation imposed on one but not all stock yards).

[54] There is no legal prohibition against selection of tenants based upon ability to pay, as recognized by Justice Mosk. *Pennell v. City of San Jose*, 42 Cal.3d 365, 377 (Mosk, J. dissenting).

[55] See Brief Amicus Curiae of the Califorina Association of Realtors, pp 10-13; Brief of Amicus Curiae The Washington Legal Foundation, pp 13-14; Brief Amicus Curiae of the Pacific Legal Foundation, pp 10-11; Brief of the National Multi Housing Council, pp 13, 18-19; Brief of Amicus Curiae of the California Association of Realtors, pp 13-15; Brief Amicus Curiae of the Competitive Enterprise Institute, pp 12-14.

Equally as important, by granting a privilege to those hardship tenants currently renting apartments, the Ordinance discriminates in favor of current residents against those hardship tenants seeking housing.[56]

V
CONCLUSION

The police power has its limitations. The sage observation of Justice Holmes 65 years ago is even more appropriate today.

> "In general it is not plain that a man's misfortunes or necessities will justify his shifting the damages to his neighbor's shoulders .... We are in danger of forgetting that a strong public desire to improve the public condition is not enough to warrant achieving the desire by a shorter cut than the constitutional way of paying for the change." *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 416 (1922).

The decision of the California Supreme Court should be reversed.

Dated: October 28, 1987

MILLER, STARR & REGALIA

By: HARRY D. MILLER

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[56] See, *Zobel v. Williams*, 102 S.Ct. 2309, 2314-2315 (1982); *Shapiro v. Thompson*, 394 U.S. 618 (1969).

AMICUS CURIAE

BRIEF

Supreme Court, U.S.
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No. 86-753

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

RICHARD PENNELL and TRI-COUNTY
APARTMENT HOUSE OWNERS ASSOCIATION,
Appellants,
v.
CITY OF SAN JOSE and CITY COUNCIL
OF THE CITY OF SAN JOSE,
Appellees.

On Appeal from the Supreme Court of the State of California

BRIEF AMICI CURIAE FOR RENT STABILIZATION ASSOCIATION OF NEW YORK CITY, INC., ASSOCIATED BUILDERS AND OWNERS OF NEW YORK, REAL ESTATE BOARD OF NEW YORK, AND BRONX REALTY ADVISORY BOARD IN SUPPORT OF APPELLANT

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QUESTION PRESENTED

Are municipal rent control regulations that require individual property owners to reduce reasonable rent increases whenever any individual tenant experiences economic hardship, and that prevent lessors from terminating contractual relations with individual lessees unable to pay such increases, repugnant to the Takings, Due Process, or Equal Protection clauses of the Fifth and Fourteenth Amendments?

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**On Appeal from the Supreme Court of the
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BRIEF AMICI CURIAE FOR RENT STABILIZATION ASSOCIATION OF NEW YORK CITY, INC., ASSOCIATED BUILDERS AND OWNERS OF NEW YORK, REAL ESTATE BOARD OF NEW YORK, AND BRONX REALTY ADVISORY BOARD IN SUPPORT OF APPELLANT

This brief is filed on behalf of the Rent Stabilization Association of New York City, Inc., the Associated Builders and Owners of New York, the Real Estate Board of New York, and the Bronx Realty Advisory Board.[1]

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[1] Consent from counsel for all parties has been filed with the Clerk of this Court.

INTEREST OF THE AMICI

The four amici are associations of landlords and real estate operators in the Greater New York area. The Rent Stabilization Association has 20,000 members, with approximately 650,000 units of housing. The Associated Builders and Owners of New York has 435 members. They have approximately 300,000 units, of which a little less than 100,000 are cooperatives. The Real Estate Board of New York has 5,500 members. The Bronx Realty Advisory Board has 1,000 owners, with 1,250 buildings, and approximately 75,000 apartments.

These organizations, and their members, have a clear and definite interest in the question raised in this case, namely, the validity of the provision of the San Jose Ordinance requiring that hardship of "a particular tenant" must be taken into account in determining the allowable rent for a housing unit.

STATEMENT

San Jose Ordinance No. 19696, the "San Jose Rental Dispute Mediation and Arbitration Ordinance" (the "Ordinance"),[2] creates a mediation and arbitration procedure by which, in general, an individual tenant can invoke the City's aid to postpone or prevent any scheduled "rent increase" that exceeds eight percent of the annual rent. The Ordinance applies exclusively to privately owned and maintained rental housing; "[r]ental units owned or operated by any governmental agency or *whose rent is subsidized by any government agency*" are explicitly excluded. Ordinance, at § 5702.12(c) (emphasis added). "Rent increase," as defined in the Ordinance, is not limited to increases in the amount of rent due, but also includes any "reduction in [services, benefits, or privileges] without a corresponding reduction in the monies demanded or paid for rent." Ordinance, at § 5702.11.

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[2] The full text of the Ordinance is set out in Appendix E to appellants' Jurisdictional Statement at pages A-34 through A-50.

The arbitration and mediation procedure established by the Ordinance empowers hearing officers to determine whether challenged increases "are reasonable under the circumstances taking into consideration that the purpose of this Ordinance is to permit landlords a fair and reasonable return on the value of their property while protecting tenants from arbitrary, capricious or unreasonable rent increases, and under certain circumstances, unjustified economic hardship." *Id.*, at § 5703.28. The stated justification for the scheme is that

> there is a growing shortage of and increasing demand for housing in the City of San Jose. This circumstance coupled with increasing inflation, the rising cost of developing new housing, and other factors have put substantial upward pressure on residential rents.

Ordinance, at § 5701.2. Although the Ordinance subsequently refers to a need to prevent "excessive and unreasonable rent increases," no non-cost related factors are specified as contributing to the perceived problem. Nor does the Ordinance explain how restricting returns earned by owners of rental property could be expected to ease the rental housing shortage.

Under the Ordinance, property owners must bear the burden in mediation and arbitration proceedings of proving the reasonableness of all rent increases exceeding eight percent. Ordinance, at § 5703.17. The only such increases deemed reasonable under the Ordinance are those limited to specified costs of business plus an annual return of five percent. *Id.*, at § 5703.28(a), (b). All other challenged increases are to be considered by hearing officers in the light of seven enumerated factors. Six of the seven factors concern the value of the leasehold and the owner's financial situation. Ordinance, at § 5703.28 (c). The seventh, however, focuses on "the hardship to a tenant, as provided in Section 5703.29." This Section of the Ordinance provides:

> the Hearing Officer shall consider the economic and financial hardship imposed on the present tenant or tenants of the unit or units to which such increases apply. If, on balance, the Hearing Officer determines that the proposed increase constitutes an unreasonably severe financial or economic hardship of a particular tenant, he may order that the excess [i.e., the amount exceeding five percent plus the costs specified in Section 5703.28(a) and (b)], or any portion thereof, be disallowed. Any tenant whose household income and monthly housing expense meets the criteria established by the Housing Assistance Payments Program under Section 8, existing housing provisions of the Housing and Community Development Act of 1974 (P.L. 93-383) and the regulations pertaining thereto, shall be deemed to be suffering under financial and economic hardship which must be weighed in the Hearing Officer's determination. The burden of proof in establishing any other economic hardship shall be on the tenant.

Ordinance, at § 5703.29 (emphasis added).

The Ordinance further provides that a property owner who charges a rent higher than that allowed by a hearing officer is guilty of a misdemeanor and is liable to the tenant(s) for a non-exclusive monetary penalty. *Id.*, at §§ 5706.4, 5706.5. The Ordinance also contains limitations on the rights of owners to recover possession of their property. Ordinance, at § 5706.1.

As construed by the California Supreme Court, the hardship factor "is given potentially overriding weight in the ordinance, under which the hearing officer is (i) *directed* to consider the economic or financial effect of the proposed increase on the affected tenant, and is (ii) *permitted* to disallow all or part of an increase over that allowed by the [Ordinance's stringent costs-plus-five-percent standards] if that part of the increase would impose an unreasonably severe financial or economic hardship on a particular tenant." 42 Cal.3d at 369.

Owners and operators of residential properties in San Jose instituted this suit in Santa Clara Superior Court, challenging the constitutionality of the Ordinance's hardship provisions. The trial court held those provisions invalid, deciding that they violated the Takings Clause of the United States Constitution by "obligat[ing] private individuals to assume public burdens without just compensation." *See* Jurisdictional Statement, at A-31. The California Court of Appeals affirmed the holding, citing the Takings, Due Process, and Equal Protection clauses. 154 Cal.App.3d 1019 (1986); Jurisdictional Statement, at A-17. The California Supreme Court, however, reversed.

Appellants then sought review in this Court.

SUMMARY OF ARGUMENT[3]

1. The purpose and effect of the Ordinance's hardship provisions are to impel individual property owners to subsidize specific tenants who cannot comfortably pay reasonable rent increases. Although the subsidies flow under the Ordinance to tenants experiencing "financial or economic hardship," the Ordinance does not define the latter term, and leaves decisions as to what constitutes a hardship to hearing officers' discretion. The City thus takes owners' property—*i.e.*, reasonable rent increases—for the benefit of private citizens, without compensation, in violation of the Takings Clause.

2. Government-backed physical occupation of private property without compensation constitutes a per se violation of the Takings Clause. *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982). Provisions of the Ordinance forbidding property owners from terminating contractual relations with hardship tenants give those tenants and the City of San Jose complete discretion to occupy the owners' property indefinitely. Such occupation unconstitutionally infringes upon owners' fundamental

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[3] Amici deal only with the constitutional question.

property rights to exclude, and impermissibly acquires private resources to facilitate uniquely governmental functions.

3. The Takings Clause, Due Process Clause, and Equal Protection Clause establish that a public burden cannot be allocated among private citizens in an arbitrary or disproportionate manner. To the extent that the Ordinance's hardship provisions serve any public purpose, they are nonetheless invalid, because they allocate the economic burden incident to that purpose in an arbitrary, inequitable manner. Specifically, they discriminate unreasonably between property owners who receive Section 8 subsidies and those who do not, and between owners with many hardship tenants and owners with none; and they confiscate returns on investment that owners reasonably expected to earn.

4. Contrary to the conclusion of the California Supreme Court in the decision under review, the hardship provisions are not made valid by the possibility that hearing officers may read them out of the Ordinance. The California Supreme Court also erred in assuming that the eight percent rent increases automatically permitted under the Ordinance would adequately protect property owners' constitutional rights, since it is a judicial, and not a legislative, task to determine what amount will constitute "just compensation" for takings of private property. The California court erred as well in assuming that a rent control ordinance regulating only low- and medium-cost housing would be constitutional; and, in any event, the Ordinance would not be analogous to such a scheme.

ARGUMENT

I. THE HARDSHIP PROVISIONS OF THE ORDINANCE CONSTITUTE A GOVERNMENTAL "TAKING" OF PRIVATE PROPERTY FOR PRIVATE USE

The procedural setting and the complexity of the Ordinance cannot conceal one critical fact: the City's rent control scheme effects a direct and explicit, government-sponsored, "taking" of private property for wholly private uses. A challenged rent increase that is "reasonable under the circumstances" in view of the leasehold's value and the property owner's costs and financial stability nonetheless will be reduced under Section 5703.29 whenever a hearing officer is persuaded "on balance" that a "particular tenant" is experiencing an "unreasonably severe financial or economic hardship." There are no limits in the Ordinance as to what a hearing officer may properly consider to be an "unreasonably severe financial or economic hardship," nor are there any limits upon the types of evidence which may be received on the hardship issue. Tenants need not be at or below the poverty level to receive the benefit of Section 5703.29, and are not required to show that no lower-priced rental housing is available to them. The extent to which any tenant is responsible for his "hardship" by, for example, choosing to live in a luxury apartment, is not a factor in the legislative equation. In short, the hardship provisions do not purport to serve any public purpose, and require, at a hearing officer's discretion, mandatory subsidizing by individual property owners of individual tenants.

The "Takings Clause" of the Fifth Amendment—applicable to the States and their political subdivisions through the Fourteenth Amendment, *Chicago, Burlington and Quincy Railroad v. Chicago*, 166 U.S. 226, 236 (1897)—implicitly prohibits governmental taking of private property for private use, *Hawaii Housing Author-*

ity v. Midkiff, 467 U.S. 229, 237, 241, 245 (1984), and permits taking for public use only upon payment of "just compensation." Rent increases scheduled in accordance with reasonable estimates of the value of the leasehold clearly constitute "property" within the meaning of the Fifth and Fourteenth Amendments. *Compare Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 160-64 (1980); *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104, 127-28 (1978); *Block v. Hirsh*, 256 U.S. 135, 157 (1921).

This Court has recognized the difficulty inherent in judicial review of what constitutes a "public use." *Berman v. Parker*, 348 U.S. 26, 32-33 (1954). The present case does not present that problem. As a constitutional matter, it is the function of the legislature, and not of executive or judicial "hearing officers," to define, in the first instance, where the public interest lies. *Id.* The Ordinance does not even purport to identify in what circumstances the public interest would be served by reduction of rent increases under the hardship provisions. Instead, proposed rent increases are to be disallowed upon a showing that "a particular tenant" is suffering from an undefined hardship. And even if the Ordinance defined what "hardship" is, eliminating an *individual* hardship "would not remedy a public harm," but would "instead provide private benefits." *See Keystone Bituminous Coal Association v. DeBenedictis*, 107 S.Ct. 1232, 1243 n. 16 (1987). As this Court there stated, courts must "examine the operative provisions of a statute, not just its stated purpose, in assessing its true nature" for purposes of the Takings Clause.

Where a statute permits a private citizen to use the power of the State to accomplish a taking of private property belonging to another, for a private purpose, that statute is invalid under the Takings Clause, as this Court has not hesitated to hold on numerous occasions. *E.g., Treigie v. Acme Homestead Association*, 297 U.S. 189 (1936); *Chicago, St. Paul, Minneapolis & Omaha Railway v. Holmberg*, 282 U.S. 162 (1930); *Great Northern Railway v. Minnesota*, 238 U.S. 340 (1915); *Missouri Pacific Railway v. Nebraska*, 217 U.S. 196 (1910); *Missouri Pacific Railway v. Nebraska*, 164 U.S. 403, 416 (1896).

II. THE HARDSHIP PROVISIONS OF THE ORDINANCE UNCONSTITUTIONALLY EFFECT A PERMANENT PHYSICAL OCCUPATION OF PRIVATELY-OWNED PROPERTY WITHOUT COMPENSATION

Legislation which compels an owner of private property to endure without compensation a permanent physical occupation of his property by another contravenes the Takings Clause. *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982). The size of the area occupied is irrelevant to the takings issue. *Id.* at 436-37, 438 n.16. Also irrelevant are the ends actually or ostensibly achieved by the legislation. *Id.* at 425-35. Occupation by private third parties pursuant to government regulation in such circumstances is fully as unconstitutional as occupation by the government itself. *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. at 432-33 n.9. *Cf. Penn Central Transportation Co. v. City of New York*, 438 U.S. 104, 128 (1978) ("government actions that may be characterized as acquisitions of resources to facilitate uniquely public functions have often been held to constitute takings").

The per se rule against uncompensated occupation recognizes that occupation is "qualitatively more severe than a regulation of the *use* of property . . . since the owner may have no control over the timing, extent, or nature of the invasion," and since occupation effectively destroys all of the owner's rights to possess, use, and dispose of the property. *Loretto*, 458 U.S. at 435-36 (emphasis in original).

Through the Ordinance, San Jose not only obliges property owners to subsidize hardship tenants—it also acquires a perpetual right of occupation of the leased premises for the benefit of individual hardship tenants. Owners may not simply choose not to renew contractual relations with tenants whose financial circumstances make payment of a reasonable rent difficult: the Ordinance specifically provides that "[p]ossession of a rental unit shall not be recovered by a landlord from a tenant who is not otherwise in default as to the terms of occupancy of said unit, if . . . the dominant motive of the landlord . . . is to evade the purposes of this Chapter." Ordinance, at § 5706.1. One of the stated purposes of the Ordinance is "alleviation of undue hardship upon individual tenants." *Id.*, at § 5701.2.

Thus, just as apartment owners in *Loretto* were by law subject to the will of a third party—a cable television company—as to whether their property would be physically occupied without compensation, so are property owners here subject under the Ordinance to the will of individual hardship tenants as to whether the owners' rental units will be permanently occupied at rents adjusted downward without compensation by reason of tenant hardship. Under the Ordinance, hardship tenants are transformed from lessees to "interloper[s] with a government license," abrogating the property owner's rights to exclude them. *FCC v. Florida Power Corp.*, 107 S.Ct. 1107, 1112 (1987). The "'right to exclude,' so universally held to be a fundamental element of the property right, falls within [the] category of interests that the Government cannot take without compensation." *Kaiser Aetna v. United States*, 444 U.S. 164, 179-80 (1979) (footnote omitted). *Accord*, *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1011 (1984).

Because the hardship provisions thus accomplish a physical occupation of private property without compensation, and because they make use of the resources of property owners to facilitate the uniquely governmental function of providing housing for persons believed by government officials to be in need, those provisions are invalid under the Takings Clause.[4]

III. THE HARDSHIP PROVISIONS OF THE ORDINANCE ARE UNCONSTITUTIONAL BECAUSE THEY PLACE AN UNDUE BURDEN UPON INDIVIDUAL OWNERS OF RENTAL UNITS

Even if a *public* purpose had been defined for the hardship provisions in San Jose's rent control scheme, and even if they did not accomplish a physical occupation of private property without compensation, those provisions still would fail to pass muster under the Constitution. Cases decided under the Takings Clause, the Due Process Clause, and the Equal Protection Clause firmly establish that individual citizens cannot be required to shoulder an undue or arbitrary share of a public burden. Instead, "'[j]ustice and fairness' require that economic injuries caused by public action be compensated by government, rather than remain disproportionately concentrated on a few persons." *Kaiser Aetna v. United States*, 444 U.S. 164, 176 (1979). *Accord*, *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 163 (1980); *PruneYard Shopping Center v. Robins*, 447 U.S. 74, 83 n.7 (1980); *Agins v. City of Tiburon*, 447 U.S. 255, 260 (1980); *Armstrong v. United States*, 364 U.S. 40, 49 (1960); *Monongahela Navigation Co. v. United States*, 148 U.S. 312, 325 (1893).

Thus, the Constitution prohibits a State from singling out one citizen for more burdensome tax treatment than that otherwise applicable to members of the public. *Road Improvement District No. 1 v. Missouri Pacific Railroad*, 274 U.S. 188 (1927); *Raymond v. Chicago Union Traction Co.*, 207 U.S. 20 (1907). And while a railroad company may be compelled to dismantle a bridge which would obstruct plans for drainage improvements, it may not be compelled to perform the planned improvements itself. *Chicago, Burlington and Quincy Railway v. Illinois ex rel. Grimwood*, 200 U.S. 561, 594 (1906). Similarly, a landowner properly subject to special assessments for construction of a road abutting his property cannot be forced to pay such assessments in an amount exceeding the value of his land. *Village of Norwood v. Baker*, 172 U.S. 269 (1898). *See also Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. at 164-65 (State's effort to retain interest that had accrued on a fund deposited with a State court in an interpleader action constituted an impermissible "taking," since it was a "forced contribution to general government revenues, not reasonably related to" the governmental services that the private plaintiff had obtained).

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[4] It is by no means clear that property owners with hardship tenants could, consistently with the Ordinance, simply convert their rental properties to other uses. But even if that alternative is available, "a landlord's ability to rent his property may not be conditioned on his forfeiting the right to compensation for a physical occupation." *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. at 439 n.17.

The fact that each parcel of real property is unique in terms of location and character makes the constitutional goal of equitable sharing of public burdens more difficult to achieve in the context of land use regulations. The public interest precludes exactitude in allocations of public burdens in this area. *See, e.g., Penn Central Transportation Co. v. City of New York*, 438 U.S. 104, 133 (1978). But this does not mean that the Constitution imposes no proportionality or arbitrariness limitations on the government's power to place public burdens on selected private landowners; nor does it mean that the Court's decisions have failed to establish any principles by which such limitations are to be applied.

Thus, it is clear that there is constitutional protection for a landowner's "investment-backed expectations." *Id.*, at 127. *Accord, Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. at 426; *Kaiser Aetna v. United States*, 444 U.S. at 175, 179-80. The economic impact and character of the governmental action must receive careful attention. *Kaiser Aetna v. United States*, 444 U.S. at 175. *See also Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. at 163-64; *Armstrong v. United States*, 346 U.S. at 48-49. And while "mere 'consequential incidence[s]' of a valid regulatory measure" need not be compensated, the fact that the government's purpose and intent may not have been to burden property rights is not controlling. *See Armstrong v. United States*, 364 U.S. at 48-49. Moreover, the fact that property may retain some usefulness to its owner following government regulation is irrelevant in determining the economic impact of the regulation. *Ruckelshaus v. Monsanto Co.*, 467 U.S. at 1012.

As noted above, the individual "hardship" provisions of the Ordinance are designed to provide economic subsidies, at the expense of individual property owners, to "a particular tenant" who convinces a hearing officer that he or she is experiencing an economic or financial hardship of some kind. Thus, the provisions do not serve a public purpose.[5] The only portion of the provisions with a clear relationship to a public purpose is the language in Section 5703.29 creating a presumption of hardship for those individual tenants who happen to be within the protection of the rent control scheme (*see* Section 5703.3 of the Ordinance) and whose "household income and monthly housing expense mee[t] the criteria established by the Housing Assistance Payments Program under Section 8, existing housing provisions of the Housing and Community Development Act of 1974 (P.L. 93-383) and the regulations pertaining thereto."

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[5] For this reason, the present case is distinguishable from *Nollan v. California Coastal Commission*, 177 Cal.App.3d 719 (1986), presently before this Court in No. 86-133, argued on March 30, 1987.

But even if the latter language could be read as partially identifying a public interest in the welfare of particular tenants who spend a high percentage of their income on housing,[6] the Ordinance effects this purpose in an unconstitutional manner. "Section 8" of the Housing and Community Development Act of 1974, codified as amended at 42 U.S.C. § 1437f, provides for *governmental subsidies* to be paid to owners of existing rental units whose tenants cannot pay a fair market rent because of financial hardship. The Section 8 legislation is in effect a congressional finding that the cost of providing decent housing for those financially-pressed tenants constitutes a burden that must be shared by the public at large through general tax revenues. The Ordinance, however, places that economic burden entirely on individual property owners, and even within the latter group discriminates arbitrarily between property owners who are paid Section 8 subsidies and those who are not, and between those property owners who have many "hardship" tenants and those who have few or none. The decisions of this Court establish that such an arbitrary and disproportionate allocation of public burdens is invalid under the Equal Protection, Due Process, and Takings clauses. *E.g., Road Improvement District No. 1 v. Missouri Pacific Railroad*, 274 U.S. 188 (1927); *Raymond v. Chicago Union Traction Co.*, 207 U.S. 20 (1907); *Village of Norwood v. Baker*, 172 U.S. 269 (1898).

Moreover, the hardship provisions abrogate legitimate investment-backed expectations of property owners. The entire rent control scheme applies only to existing housing. *See* Ordinance, at § 5703.3(a). Owners who invested their private funds in obtaining and maintaining the rental properties that are now subject to the Ordinance had reasonably expected that they would receive a return commensurate with market rates. The Ordinance, however, only deems reasonable those rent increases equal to the greater of current annual rents plus eight percent, or current annual rents plus five percent and specified costs. *See* Ordinance, at § 5703.28(a), (b). In addition, excluded from the costs deemed reasonable under the Ordinance are certain costs of debt service. *See* Ordinance, at § 5703.28(b). Thus, under the Ordinance, owners with hardship tenants may earn far less from their properties than they had reason to expect when they invested, and may even—if they have been forced to borrow heavily—sustain losses every year. The City's rent control scheme takes no account of investor risk—a recognized element of the constitutionally-mandated fair return in the analogous public utilities context. *See, e.g., FPC v. Texaco, Inc.*, 417 U.S. 380 (1974); *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944). In short, the Ordinance is confiscatory. At least with respect to marginal operations that have a heavy burden of debt, it does not even bear a rational relationship to the asserted interest in addressing the rental housing shortage.

The Ordinance arbitrarily and irrationally allocates the economic burden of achieving whatever public purpose it might serve among individual property owners, abrogating their reasonable investment-backed expectations without compensation. These results are not simply consequential effects of legislation designed to serve an unrelated, legitimate public purpose, but instead constitute the very rationale for the hardship provisions. Thus, the Ordinance is unconstitutional under the Due Process, Equal Protection, and Takings clauses.

IV. THE REASONING OF THE CALIFORNIA SUPREME COURT IS NOT PERSUASIVE

The California Supreme Court, in reversing the decisions of the Santa Clara Superior Court and the California Court of Appeal, reasoned that the hardship provisions are constitutional because 1) hearing officers will not necessarily accord significant weight to the hardship factor, 42 Cal.3d at 370 n.6; 2) the eight percent annual increases automatically allowable under the Ordinance constitute a sufficient return for property owners, *id.* at 373, 374; and 3) the Ordinance is indistinguishable from an assertedly permissible legislative scheme whereby rent control regulations would apply only to low- and medium-priced apartments, *id.* at 373-74. These reasons are insufficient to sustain the legislation.

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[6] The California Supreme Court noted that "[t]he number of such tenants falling within [the designated federal standards] is potentially high: Plaintiffs assert (and Defendants do not contend otherwise) that the federal standards are met by all families whose incomes are less than 80 percent of the median family income in this area." 42 Cal.3d at 370.

First, the Ordinance cannot be upheld as valid on its face on the assumption that hearing officers will not apply it according to its own terms. The Ordinance *directs* hearing officers to consider hardship, and, as the California Supreme Court acknowledged, gives that factor "potentially overriding weight." 42 Cal.3d at 369. The fact that considerations consistent with the property owner's reasonable investment-backed expectations may, in the hearing officer's judgment, outweigh the hardship factor in a particular case cannot write the hardship provisions out of the Ordinance.[7]

That a property owner can increase his rent eight percent annually without becoming subject to the mediation and arbitration procedures is also irrelevant to the constitutional issues raised here. A legislative judgment that a flat rate of eight percent in all cases will sufficiently compensate property owners has no adequate foundation. As this Court has held,

> [T]he right to determine what shall be the measure of compensation . . . is a judicial and not a legislative question. It does not rest with the public, taking the property through Congress or the legislature, its representative, to say what compensation shall be paid, or even what shall be the rule of compensation.

Monongahela Navigation Co. v. United States, 148 U.S. 312, 327 (1893).

With respect to the California Supreme Court's assertion that the Ordinance is indistinguishable from a scheme whereby rent control regulation would be applicable only to low- and medium-priced housing, amici first contend that such a scheme would itself be unconstitutional for many of the same reasons stated above. Even if this were not so, however, the San Jose system is indeed distinguishable. The Ordinance *arbitrarily* allocates the economic burden of subsidizing particular hardship tenants according to how many such tenants an individual property owner may happen to have. There is *no* rational basis for such an allocation. It can only be expected to discourage property owners in the first instance from renting to individuals having greater financial obligations (such as a family, for example) or more limited financial resources. And whereas the investments made by property owners charging low or moderate rents no doubt were made with the financial limitations of the prospective tenant class in mind, the investments made by owners of more luxurious rental units certainly were not geared to the possibility of tenant hardship severe enough to implicate the public interest. Yet the hardship provisions apply to high-priced housing as well as to low- or moderate-priced housing.

Clearly, the arguments stated by the California Supreme Court do not cure the constitutional defects identified in the opening portion of this brief.

---

[7] Thus, the California Supreme Court's statement in 42 Cal.3d at 369 n.5 that "the ordinance grants all landlords the same constitutional fair return, and simply grants to those whose tenants can afford it an additional increase above that constitutionally required" cannot withstand analysis. There is nothing in the Ordinance permitting hearing officers to allow additional increases where tenants can "afford it."

CONCLUSION

For the reasons set forth above and for the additional reasons advanced in appellants' brief, the decision of the California Supreme Court should be reversed.

Respectfully submitted,

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AMICUS CURIAE

BRIEF

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No. 86-753.

In the
Supreme Court of the United States.

October Term, 1986.

RICHARD PENNELL and TRI-COUNTY
APARTMENT HOUSE OWNERS ASSOCIATION,
Appellants,

v.

CITY OF SAN JOSE and CITY COUNCIL OF
THE CITY OF SAN JOSE,
Appellees.

ON APPEAL FROM THE CALIFORNIA SUPREME COURT.

Brief of the National Association of Home Builders and the California Building Industry Association as Amici Curiae in Support of Appellants.

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No. 86-753.

In the

Supreme Court of the United States.

OCTOBER TERM, 1986.

RICHARD PENNELL AND TRI-COUNTY
APARTMENT HOUSE OWNERS ASSOCIATION,
APPELLANTS,

v.

CITY OF SAN JOSE AND CITY COUNCIL OF
THE CITY OF SAN JOSE,
APPELLEES.

ON APPEAL FROM THE CALIFORNIA SUPREME COURT.

Brief of the National Association of Home Builders and the California Building Industry Association as Amici Curiae in Support of Appellants.

The National Association of Home Builders and the California Building Industry Association have received the parties' written consent to file this brief as *Amici Curiae* in support of the Appellants and have filed their letters of consent with the Clerk of this Court.

Interest of the Amici Curiae.

The National Association of Home Builders represents 147,000 builder and associate members organized into approximately 800 affiliated state and local associations in all fifty states, the District of Columbia, and Puerto Rico. Its members include not only those who build single-family homes, but also apartment, condominium, commercial and industrial builders, as well as land developers and remodelers. It is the voice of the American shelter industry.

The California Building Industry Association, a state affiliate of the National Association of Home Builders, is a federation of seven regional and local associations representing 5,400 members building most of California's housing.

The interest of the Amici is in seeing that suppliers of housing can do the job they are most qualified to do: build and operate housing for millions of Americans at prices that are affordable. The Amici believe that an economically healthy housing industry, reasonably regulated by government to promote the health, safety and general welfare of the people, can best achieve that goal. It is when government attempts to impose unreasonable regulations upon housing suppliers, restrictions that impede the central goal of providing housing, that the Amici must express grave concern.

In San Jose, as elsewhere, the community has chosen to use a system of price controls on residential rents to prevent excessive rents caused by housing supply shortages. The Amici believe as a matter of public policy that the *effect* of rent control frequently defeats its laudable intent: that is, rent control itself contributes to rather than mitigates housing supply-

demand imbalances by discouraging investment in the construction, rehabilitation and maintenance of housing stock.[1]

This effect is exacerbated where, as here, the specific rent control law may operate to prevent residential property owners from receiving a reasonable return on their investments. San Jose's ordinance ensures this result by allowing a tenant's individual economic hardship status to supercede the owner's reasonable return. Such statutory quashing of financial rates of return severely impedes the free flow of money from capital markets to the housing sector,[2] diverting funds to other sectors of the economy where higher financial returns can be attained. Of course, the Amici appreciate that this view is properly addressed not to the judicial branch, but to public policymakers, those legislators and executive officials who write and administer the laws.

The Amici argue herein not policy, but constitutional law, believing that the San Jose Rental Dispute Mediation and Arbitration Ordinance violates the Just Compensation Clause of the United States Constitution because it fails to guarantee owners of residential property economically viable use of their property. While the Amici applaud the City of San Jose's concern for making housing available and affordable for all its residents, the Amici nevertheless believe that property owners may not be asked to accomplish this mission when they are denied the constitutionally-required economically viable use.

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[1] A copious literature explores these issues. *See, e.g.*, W. Block & E. Olsen, eds., *Rent Control* (1981); M. Lett, *Rent Control: Concepts, Realities and Mechanisms* (1976); G. Sternlieb, *The Urban Housing Dilemma: The Dynamics of New York City's Rent Controlled Housing* (1972).

[2] *See* G. Sternlieb & J. Hughes, *The Future of Rental Housing* 93 (1981).

Summary of Argument.

The Just Compensation Clause of the United States Constitution guarantees all property owners economically viable use of their property. Thus, when government regulates property, no matter what the public interest served, the minimum standard of economic viability must be observed. In this way, the Constitution ensures that the benefits and burdens of participating in our society are not unreasonably distributed, and that burdens more properly borne by the pubiic at large are not imposed on a small class of individuals.

The City of San Jose has enacted a rent control ordinance that, although providing for annual rent increases, fails to guarantee that owners of residential property will have the opportunity to earn a reasonable return on their investment. The Ordinance contains an unusual provision allowing a tenant's individual economic hardship to override rent increases that may be necessary to secure the constitutionally minimum standard for owners. By expressly authorizing its administrators to follow a constitutionally defective standard, the Ordinance is invalid on its face.

The City of San Jose should amend its Ordinance so that residential property owners, in the operation of their rental projects, may be certain of achieving the constitutionally-guaranteed economically viable use.

Argument.

I. THE SAN JOSE ORDINANCE OPERATES TO DEPRIVE RESIDENTIAL PROPERTY OWNERS OF THEIR CONSTITUTIONALLY-REQUIRED ECONOMICALLY VIABLE USE.

A. *The Just Compensation Clause of the Fifth Amendment of the United States Constitution Guarantees a Reasonable Return on Private Property Investments.*

The Just Compensation Clause of the United States Constitution's Fifth Amendment, made applicable to the States through the Fourteenth Amendment, *Keystone Bituminous Coal Association* v. *DeBenedictis*, 107 S.Ct. 1232, 1240 n.10 (1987), states, "[N]or shall private property be taken for public use, without just compensation." Although it is clear that no magic formula exists to resolve every "takings" challenge to government regulation, *see Goldblatt* v. *Town of Hempstead*, 369 U.S. 590, 594 (1962), it is equally clear that property owners must be left *in all cases* with a reasonable economic use of their property.

In *Agins* v. *City of Tiburon*, 447 U.S. 255 (1980), the Court recapitulated the general test for "takings" challenges to regulations, holding that a regulation "effects a taking if the ordinance does not substantially advance legitimate state interests . . . or [if it] denies an owner economically viable use of his land. . . ." *Id.* at 260; *e.g.*, *Keystone*, *supra*, 107 S.Ct. at 1242; *United States* v. *Riverside Bayview Homes, Inc.*, 106 S.Ct. 455, 459 (1985). The minimum guarantee of "economically viable use" prevails, *see Kirby Forest Industries, Inc.* v. *United States*, 467 U.S. 1, 14 (1984); *Hodel* v. *Virginia Surface Mining & Reclamation Association*, 452 U.S. 264, 296 (1981), no matter how legitimate or important the public purpose.

When analyzing the effect of government regulation on income-producing private property, the Court has used a variety of words and phrases, including the financial language of "reasonable return," "profit," "commercially impracticable," and "distinct investment-backed expectations," to mark the constitutionally-required minimum.[3] For example, in approving New York City's Landmarks Law, the Court observed that the law permitted appellant Penn Central "not only to profit from the [Grand Central] Terminal but also to obtain a 'reasonable return' on its investment," *Penn Central Transp. Co.* v. *New York City*, 438 U.S. 104, 136 (1978), further noting that appellant never disputed that its property was "capable of earning a reasonable return," *id.* at 129. Thus, the Court held, the law "has not effected a 'taking' of appellant's property" because the restrictions "permit reasonable beneficial use of the landmark site." *Id.* at 138. This past Term, the Court examined whether a challenged regulation "makes it impossible for petitioners to profitably engage in their business, or that there has been undue interference with their investment-backed expectations." *Keystone, supra,* 107 S.Ct. at 1242.[4]

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[3] *See, e.g., Keystone Bituminous Coal Association* v. *DeBenedictis,* 107 S.Ct. 1232, 1242, 1246 (1987) ("investment-backed expectations;" "commercially impracticable"); *Williamson County Regional Planning Commission* v. *Hamilton Bank,* 105 S.Ct. 3108, 3119 (1985) ("investment-backed profit expectations"); *Penn Central Transp. Co.* v. *New York City,* 438 U.S. 104, 129, 136, 138 (1978) ("profit;" "reasonable return;" "reasonable beneficial use").

The Court has frequently rehearsed the signposts of the "takings" test: "we have identified three factors which have 'particular significance:' (1) 'the economic impact of the regulation on the claimant'; (2) 'the extent to which the regulation has interfered with distinct investment-backed expectations'; and (3) 'the character of the governmental action.'" *Connolly* v. *Pension Benefit Guaranty Corp.,* 106 S.Ct. 1018, 1026 (1986); *see, e.g., MacDonald, Sommer & Frates* v. *Yolo County,* 106 S.Ct. 2561, 2566 (1986); *Williamson, supra,* 105 S.Ct. at 3119; *Ruckelshaus* v. *Monsanto Co.,* 467 U.S. 986, 1005 (1984); *Kaiser Aetna* v. *United States,* 444 U.S. 164, 175 (1979); *Penn Central, supra,* 438 U.S. at 124.

[4] The Court upheld the restriction on coal mining operations, finding that "only about 75% of petitioners' underground coal can be profitably mined in any event, and there is no showing that petitioners' 'reasonable investment-backed expectations' have been materially affected . . . ." *Keystone, supra,* 107 S.Ct. at 1249.

At the heart of Just Compensation Clause jurisprudence is a compromise between public and private rights. Property owners are not inevitably entitled to an unfettered "highest and best" or most profitable use value of their properties, *see Goldblatt* v. *Town of Hempstead, supra,* 369 U.S. at 592-593, for, as Justice Holmes has observed, "[g]overnment hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law. As long recognized, some values are enjoyed under an implied limitation and must yield to the police power," *Pennsylvania Coal Co.* v. *Mahon,* 260 U.S. 393, 413 (1922).

This "social contract" justifying some diminution of property value is premised on the notion of an "average reciprocity of advantage." *Id.* at 415. Thus, while the imposition of legitimate regulations will burden some individuals more than others, the restricted individuals will similarly benefit from restrictions placed on others. *Keystone, supra,* 107 S.Ct. at 1245; *Agins, supra,* 447 U.S. at 260. As long as the distribution of burdens and benefits is broadly — albeit not precisely — fair and equitable, then the "average reciprocity of advantage" principle implicit in the Just Compensation Clause is honored.

Tempering the burdens imposed by the "social contract" is the explicit minimum guarantee upon which all property owners rely, namely that they are entitled in all cases to an economically viable use. As Justice Holmes explained the contract's outer contours, "while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking." *Pennsylvania Coal, supra,* 260 U.S. at 415.[5] Thus, although governments may, through regulation, affect properties along a broad spectrum of value, the owner's *general* uncertainty is offset by the *specific* certainty of a minimum right to a reasonable return.

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[5] He specifically talked in terms of diminution of value: "when [the extent of the value] diminution reaches a certain magnitude, in most if not in all cases there must be an exercise of eminent domain and compensation to sustain the act." *Pennsylvania Coal Co.* v. *Mahon,* 260 U.S. 393, 413 (1922).

B. *The San Jose Ordinance Does Not Guarantee Residential Property Owners Their Constitutionally-Required Reasonable Return.*

1. None of the Ordinance's Four Methods of Rent Increases Guarantees a Reasonable Return.

The San Jose Rental Dispute Mediation and Arbitration Ordinance, San Jose, Cal., Ordinance 19696 (1979) (hereafter the "Ordinance") regulates residential rents in the City of San Jose by restricting the amount of increase that owners of residential property may receive in any given year. The Ordinance spells out several methods for calculating allowable increases, but the overall effect of these methods is that, although an owner may raise rents, he is not guaranteed a reasonable return on his investment. In this way, the Ordinance violates the Just Compensation Clause.[6]

In order to understand how the Ordinance violates the Just Compensation Clause, it is necessary to understand how the Ordinance *on its face* permits owners to be deprived of the constitutionally-guaranteed return. The Ordinance sets forth a detailed framework for regulation of rents in San Jose, providing four methods to determine allowable annual rent increases.

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[6] *See, e.g., Helmsley* v. *Borough of Fort Lee*, 78 N.J. 200, 394 A.2d 65, 70 (1978), *appeal dismissed*, 440 U.S. 978 (1979) ("We turn now to the constitutionality of [the Ordinance]. . . . It is axiomatic that a rent control ordinance must permit an efficient landlord to realize a 'just and reasonable return' on his property. . . ."); *Zussman* v. *Rent Control Board*, 371 Mass. 632, 359 N.E.2d 29, 32 (1976) (court's "'sole task is to determine the lowest constitutionally permissible rate'" and that rents must "'be set so as to assure to landlords a reasonable return on their investment.'").

First, an owner may automatically raise rents in any 12-month period by a total of eight percent (8%).[7]

Second, an owner may raise rents more than the eight percent[8] if the increase consists of a pass-through of additional capital, operating and/or rehabilitation costs plus no more than five percent (5%) of rents.[9]

---

[7] Section 5703.2 of the Ordinance states:

> "Increases Subject to Review. Except as hereinafter provided, any rent increase or combination of increases occurring after March 31, 1979, and prior to the effective date of this ordinance, which taken together with any increase which took effect in the twelve (12) month period immediately preceding such increase, exceeds an aggregate of eight percent (8%) shall be subject to review under the Hearing Process."

[8] Section 5703.11 of the Ordinance provides that an owner must inform the tenant of his right to utilize the City of San Jose's Rental Dispute Mediation and Arbitration Hearing Process if the rent increase exceeds the automatic eight percent.

[9] Section 5703.28(a) of the Ordinance states:

> "Increases Deemed Reasonable. Where the amount of the proposed rental increase consists only of passing through one or more of the following: (i) costs of capital improvements, (ii) increased costs of maintenance and operation, or (iii) costs of rehabilitation; plus no more than five percent (5%) of the monthly rent, they shall be deemed reasonable and the Hearing Officer shall allow the entire rental increase provided that:
>
> (1) cost figures have been established to his reasonable satisfaction;
>
> (2) the costs of capital improvements if any are averaged on a per unit basis and are amortized over a period not less than sixty (60) months;
>
> (3) the costs of rehabilitation if any are averaged on a per unit basis and are amortized over a period not less than thirty-six (36) months;
>
> (4) each of the costs proposed to be passed through to tenants, whether it be costs of capital improvements, increased costs of operation and maintenance, or costs of rehabilitation, bears a reasonable relationship to the purposes for which such costs were incurred and the value of the real property to which they are applied."

Third, an owner may raise rents more than the eight percent if the increase consists of a pass-through of certain increased costs of debt service.[10]

Fourth, an owner may apply to the Hearing Officer for a rent increase that exceeds any of the foregoing three increases, but part or all of this increase may be disallowed if the tenant or tenants are suffering from financial or economic hardship.[11]

---

[10] Section 5703.28(b) of the Ordinance states:

> "When Costs of Debt Service Deemed to be Reasonable. Increased costs of debt service shall be deemed reasonable and allowed by the Hearing Officer where the aggregate amount of debt from whence they arise constitutes no more than seventy percent (70%) of the value of the property as established by a lender's appraisal, and no more than eighty percent (80%) of the cost of such debt service is being passed through to the tenants. Where no lender's appraisal is available, the Hearing Officer may secure such appraisal to be paid for by the landlord as a cost of maintenance and operation."

[11] Section 5703.28(c) of the Ordinance states:

> "Standards Applicable to Rent Increases Which Exceed the Foregoing. When the amount of any rent increase or portion thereof exceeds any of the foregoing standards under subsections (a) or (b) of this Section [the first three methods], the Hearing Officer shall determine what is reasonable under the circumstances taking into account any of the following factors on which he has received information:
>
> (1) In the case of increased costs of debt service due to a sale or refinancing of the rental units or the building or property of which the units are a part within twelve (12) months of the increase: (i) the arms length nature of the transaction, (ii) the landlord's rate of return on the investment, (iii) the frequency of past resale or refinances, and (iv) the extent to which prior rental increases have made provisions for appreciation of asset value;
>
> (2) the rental history of the unit or the complex of which it is a part, including: (i) the presence or absence of past increases, (ii) the frequency of past rent increases, (iii) the landlord's response to Proposition 13 savings, and (iv) the occupancy rate of the complex in comparison to comparable units in the same general area;
>
> (3) the physical condition of the rental unit or complex of which it is a part, including the quantity and quality of maintenance and repairs performed during the last twelve (12) months;

It is clear that none of the above four methods assures the owner a reasonable return. The first three all speak to *increases* in rent, but never address the relationship between rent increases and reasonable return. A mere increase in rent does not assure a reasonable return. It is important not to confuse an eight percent rent increase with an eight percent return on investment.[12] For example, the eight percent automatic increase method will be insufficient if costs increase at a substantially greater pace.[13] Although the second and third methods allow for passing through some cost increases, they also do not provide for a reasonable return. For example, in the case where the rents upon which the increase is calculated are already not providing a reasonable return, a pass-through increase may not provide the necessary adjustment to achieve a reasonable return.[14]

> (4) any increases or reduction of housing services since the last rental increase before the effective date of this Ordinance;
>
> (5) other financial information which the landlord is willing to provide;
>
> (6) existing market value of rents for units similarly situated;
>
> (7) the hardship to a tenant, as provided in Section 5703.29."

[12] The California Supreme Court below appears to have done just that when it refers to the automatic increase as "a *generous* 8 percent automatic increase to all landlords." *See Pennell* v. *City of San Jose*, 42 Cal.3d 365, 228 Cal. Rptr. 726, 721 P.2d 1111, 1117 (1986) (emphasis added). Without knowing the relationship between rent increases and returns on investment, the California Supreme Court's characterization of the increase as "generous" is meaningless.

[13] Such a scenario is hardly chimerical. For example, during the oil crisis of the 1970s, utility costs jumped dramatically, with concomitantly escalating operating and management expenses. Together, these increases could easily outstrip rent increases.

[14] Indeed, a later provision in the Ordinance recognizes the importance of past history, suggesting that the Hearing Officer may consider "the rental history of the unit or the complex of which it is a part, including (i) the presence or absence of past increases, (ii) the frequency of past rent increases. . . ." Section 5703.28(c)(2). Unfortunately, this provision falls in that part of the Ordinance allowing the tenant's individual economic hardship to override all or part of any increase based upon this "past history" factor. *See supra* n. 11; *infra* n.16.

The fourth method applies to rent increases that would exceed those achievable under the first three methods. However, even this method does not provide for the attainment of reasonable return, because all or part of the increase proposed here may be disallowed by the Hearing Officer if the tenant or tenants are suffering from individual economic hardship.

Under the fourth method, the Hearing Officer is directed to consider seven factors in determining "what is reasonable under the circumstances," including (1) increased costs of debt service, (2) rental history of the property, (3) its physical condition, (4) changes in housing services, (5) other financial information provided by the owner, (6) comparable market value rents, and (7) "*hardship to a tenant*." (emphasis added).[15] It is this seventh and last factor that is given overriding significance by the next section of the Ordinance. That section directs the Hearing Officer to "consider the economic and financial hardship imposed on the present tenant or tenants of the unit or units to which such increases apply," and if, "on balance, the Hearing Officer determines that the proposed increase constitutes an unreasonably severe financial or economic hardship on a particular tenant, he may order that the . . . increase . . . or any portion thereof, be disallowed."[16]

---

[15] *See supra* n.11.

[16] Section 5703.29 of the Ordinance states:

> "Hardship to Tenants. In the case of a rent increase or any portion thereof which exceeds the standard set in Section 5703.28(a) or (b), then with respect to such excess and whether or not to allow same to be part of the increase allowed under this Chapter, the Hearing Officer shall consider the economic and financial hardship imposed on the present tenant or tenants of the unit or units to which such increases apply. If, on balance, the Hearing Officer determines that the proposed increase constitutes an unreasonably severe financial or economic hardship on a particular tenant, he may order that the excess of the increase which is subject to consideration under subparagraph (c) of Section 5703.28, or any portion thereof, be disallowed. Any tenant whose household

Thus, in reviewing the full effect of the Ordinance on San Jose's residential property owners, it is clear that none of the four methods available for rent increases provides a guaranteed reasonable return as required by the Just Compensation Clause.[17]

> income and monthly housing expense meets the criteria established by the Housing Assistance Payments Program under Section 8, existing housing provisions of the Housing and Community Development Act of 1974 (P.L. 93-383) and the regulations pertaining thereto, shall be deemed to be suffering under financial and economic hardship which must be weighed in the Hearing Officer's determination. The burden of proof in establishing any other economic hardship shall be on the tenant."

[17] The California Supreme Court appears to offer an alternative reading of the San Jose Ordinance. Relying on the introductory paragraph of Section 5703.28, it suggests that the fourth method of increase guarantees owners at minimum a reasonable return. *See Pennell* v. *City of San Jose*, *supra*, 721 P.2d at 1114 n.5.

The introductory paragraph of Section 5703.28 states:

> "Standards of Reasonableness to be Applied to Rent Increases. Hearing Officers shall determine whether rent increases are reasonable under the circumstances *taking into consideration* that the *purpose* of this Ordinance is to permit landlords a fair and reasonable return on the value of their property while protecting tenants from arbitrary, capricious or unreasonable rent increases, and under certain circumstances, unjustified economic hardship. The Hearing Officer's determination shall be made with reference to the following standards. . . ." (emphasis added).

The California Supreme Court's suggestion that this introductory provision *requires* the Hearing Officer to grant owners at minimum a reasonable return is belied by the words of the Ordinance itself. The Hearing Officer is merely instructed to "tak[e] into consideration" that the Ordinance's purposes include permitting owners a reasonable return while protecting tenants from economic hardship. This consideration does not require an outcome, only consideration of the several purposes. Were it outcome determinative, then it would be no less logical to argue that it *requires* that precedence be given to the tenant's economic hardship.

It is in the subsequent specific language of Sections 5703.28(c) and 5703.29, describing the details of the fourth method of increase, that precedence of tenant economic hardship is established. The Ordinance *unequivocally* announces that any or all of the increase possible under this method may be disallowed based on the hardship of the tenant. It states that the Hearing Officer

2. The Ordinance is Facially Invalid Because It Explicitly Authorizes the Hearing Officer to Apply an Unconstitutional Standard.

As discussed *supra,* the San Jose Ordinance violates the Just Compensation Clause because it fails to guarantee property owners a reasonable return. Nevertheless, the California Supreme Court argues that, because the Ordinance does not "preclude those who administer it from avoiding confiscatory results," the Ordinance is facially constitutional. *See Pennell* v. *City of San Jose,* 42 Cal.3d 365, 228 Cal.Rptr. 726, 721 P.2d 1111, 1115 n.6 (1986). This overlooks the essential nature of what makes the Ordinance unconstitutional on its face.

If the language of a statute *expressly* authorizes its administrators to act unconstitutionally, the mere fact that it also authorizes its administrators to act constitutionally does not insulate the statute from constitutional invalidity on its face. The instant Ordinance, *fairly and properly administered* according to its *express terms,* authorizes the Hearing Officer to achieve an unconstitutional result, namely to deny owners a reasonable return on their investments. The "tenant hardship" override provision is effectively no different than an express provision in the Ordinance stating that the Hearing Officer need not grant the owner a reasonable return, clearly a facially unconstitutional proviso.

The instant challenge should be distinguished from cases where the language of a challenged statute *on its face* does not authorize unconstitutional action, although the statute's *administration* may or may not have unconstitutional consequences. *See, e.g., Hodel* v. *Virginia Surface Mining & Reclamation Association, supra,* 452 U.S. at 293-297; *FPC* v. *Texaco, Inc.,* 417 U.S. 380, 391-392 (1974). In such cases, the Court has wisely refrained from judging a statute's facial constitutionality, waiting to see how the statute will be applied.

C. *A Statutory Guarantee of a Reasonable Return in All Cases Will Cure the Ordinance's Constitutional Infirmity.*[18]

As the California Supreme Court acknowledges, the "tenant hardship" override provision of the San Jose Ordinance is not a common feature of rent control ordinances around the nation. Like the California Supreme Court, the Amici "are aware of no other rent control ordinance that contains a tenant financial hardship provision, let alone one that operates like this one." *See Pennell, supra,* 721 P.2d at 1115 (footnote omitted).[19]

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may "order that the . . . increase . . . or any portion thereof, be disallowed" based on the "economic and financial hardship imposed on the present tenant or tenants of the unit or units to which such increases apply." Section 5703.29. As this Court has recently noted, "*Pennsylvania Coal* instructs courts to examine the operative provisions of a statute, not just its stated purpose, in assessing its true nature. In *Pennsylvania Coal,* that inquiry led the Court to reject the Pennsylvania Legislature's stated purpose for the statute. . . . In this case, we, the Court of Appeals, and the District Court, have conducted the same type of inquiry the Court in *Pennsylvania Coal* conducted, and have determined that the details of the statute do not call the stated public purposes into question." *See Keystone, supra,* 107 S.Ct. at 1243 n.16.

Since the first three methods, described *supra,* already do not guarantee a reasonable return, and any increase under the fourth method may be vitiated for reasons of tenant hardship, the owner is therefore not guaranteed the constitutionally-required minimum return by the Ordinance. Nevertheless, if this Court adopts the reading suggested by the California Supreme Court, the Amici respectfully urge that this Court's opinion make clear that the Ordinance must *in all cases* guarantee owners the opportunity to raise rents sufficiently to earn a reasonable return.

[18] This is not to say that the Ordinance does not raise additional serious constitutional issues. These are addressed in other briefs before the Court and therefore are not explored herein.

[19] Although not specifically involving an override for tenant financial hardship, a New Jersey Supreme Court case has considered and held unconstitutional a provision involving special treatment for senior citizens. *See Property Owners Association* v. *Township of North Bergen,* 74 N.J. 327, 378 A.2d 25 (1977). There, the rent control ordinance permitted rent increases for all tenants but "a special class designated as Senior Tenant," and the ordinance "contained

Indeed, rent control ordinances usually expressly incorporate the reasonable return standard and provide an administrative mechanism allowing owners to obtain rent increases necessary to achieve that standard.[20]

For example, the Cambridge, Massachusetts rent control ordinance states,

> "The board shall make such individual or general adjustments, either upward or downward, of the maximum rent established . . . as may be necessary to assure that rents for controlled rental units are established at levels which yield to landlords a fair net operating income for such units."

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no provision which granted the landlord an opportunity to obtain relief [from the Senior Tenant provision] in the event that he could justify an increase. . . ." *Id.* at 27. After repeating the boilerplate constitutional rule that "'rent regulation must permit a just and reasonable return,'" the court held, "Under the terms of the ordinance, the landlord may not recoup any additional funds to which he is rightfully entitled. Imposition of that burden would deprive an owner of property without due compensation. Such rent control is confiscatory and unconstitutional." *Id.* at 29.

[20] *See Block* v. *Hirsh*, 256 U.S. 135, 157 (1921) ("Machinery is provided to secure to the landlord a reasonable rent.") In one case, where the rent control ordinance did not *expressly* provide assurance that owners would receive a reasonable return, the court held that "such a provision must be impliedly deemed to have been incorporated in it." *See Property Owners Association* v. *Township of North Bergen*, *supra*, 378 A.2d at 29. The court summarized the general rule:

> "'Every rent control ordinance must be deemed to intend, and will be so read, to permit property owners to apply to the local administrative agency for relief on the ground that the regulation entitles the owner to a just and reasonable rate of return.'"

Id.

Even the California Supreme Court has struck down as facially unconstitutional a rent control law whose procedure for rent adjustments made it impossible to increase them "without unreasonable delays." *See Birkenfeld* v. *City of Berkeley*, 17 Cal.3d 129, 130 Cal.Rptr. 465, 550 P.2d 1001, 1029-1030 (1976). As the Court observed, "The mechanism is sufficient for the required purpose only if it is capable of providing adjustments in maximum rents without a substantially greater incidence and degree of delay than is practically necessary." *Id.*

Mass. G.L. c. 36, § 7(a) (1976). The Cambridge ordinance further describes factors to be considered "in determining whether a controlled rental unit yields a fair net operating income," *id.*, § 7(b), and provides for "Rent Adjustment Hearings," *id.*, § 8. No factor can override the minimum constitutional requirement that the owner receive a reasonable return.

Rent control is only one of many regulatory areas where the requirement of reasonable return is necessarily made part of the regulation itself. For example, under New York City's Landmarks Law, restricted landmark owners may seek a "certificate of appropriateness" on the ground of "insufficient return," to ensure that the landmark designation does not cause the owner economic hardship. *See Penn Central Transp. Co.* v. *New York City*, *supra*, 438 U.S. at 103. As the Court described the operation of the New York law,

> "If the owner of the non-tax-exempt parcel has been denied certificates of appropriateness for a proposed alteration and shows that he is not earning a reasonable return on the property in its present state, the Commission and other city agencies *must* assume the burden of developing a plan that will enable the landmark owner to earn a reasonable return on the landmark site."

Id. at 103-104 n.13 (emphasis added). In other words, the statute on its face secures the constitutionally-required reasonable return, and the onus is placed on the Commission to ensure fulfillment of this standard.

The same principle underlies the basic system of zoning. The variance procedure[21] is viewed as the required "safety valve" to assure the underlying constitutionality of the general enactment. As one zoning commentator has observed,

---

[21] Under the standard zoning ordinance, variances are granted where application of the zoning would result in "undue" or "unnecessary" hardship upon the

> "The true variance is designed to preserve the constitutionality of zoning legislation. It is invoked to avoid the confiscatory effect that would follow a literal enforcement of some term of a zoning ordinance operating to deprive an owner of all beneficial use of his land."

Yokley, *Zoning Law and Practice*, § 21-2 at 263 (4th ed. 1979) (footnote omitted).[22]

Many state courts have held that the existence of a variance procedure is essential to uphold the overall constitutionality of the zoning ordinance. *See, e.g., Greenawalt* v. *Zoning Board of Adjustment*, 345 N.W.2d 537, 541-542 (Iowa 1984); *Clerics of Saint Viator, Inc.* v. *District of Columbia Board of Zoning Adjustment*, 320 A.2d 291, 294 (Dist. Col. Ct. App. 1974); *R-N-R Associates* v. *Zoning Board of Review*, 100 R.I. 7, 210 A.2d 653, 654-655 (1965); *National Land and In-*

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owner. *See, e.g., Williamson County Regional Planning Commission* v. *Hamilton Bank, supra*, 105 S.Ct. at 3114 n.3; *Florentine* v. *Town of Darien*, 142 Conn. 415, 115 A.2d 328, 332 (1955). A zoning regulation imposes unnecessary hardship

> "if property to which it applies cannot yield a reasonable return from any permitted use. Lack of a reasonable return may be shown by proof that the owner has been deprived of all beneficial use of his land."

Anderson, *American Law of Zoning 3d*, § 20.17 at 410-11 (1986) (footnote omitted); *see, e.g., Greenawalt* v. *Zoning Board of Adjustment*, 345 N.W.2d 537, 542 (Iowa 1984).

[22] *See, e.g.*, Anderson, *American Law of Zoning 3d, supra*, § 19.09 at 330-31; § 20.02 at 366 (Board of Adjustment and variance as a "safety valve," "escape hatch"); 2 Rathkopf, *The Law of Zoning and Planning*, § 37.01[1] (1986) ("prevention of confiscatory effect of ordinance by power to vary").

vestment Co. v. *Kohn*, 419 Pa. 504, 215 A.2d 597, 602 (1965); *Bieger* v. *Village of Moreland Hills*, 3 Ohio App.2d 32, 209 N.E.2d 218, 222 (Ct. App. 1965); *Florentine* v. *Town of Darien*, 142 Conn. 415, 115 A.2d 328, 332-333 (1955).[23]

By making clear that the tenant economic hardship provision may *never* override an owner's constitutional right to a reasonable return, the City of San Jose can cure its Ordinance's violation of the guarantee proffered by the Just Compensation Clause.[24]

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[23] As the *Florentine* court described,

> "A board of appeals [granting variances] is indispensable to the zoning process both from the constitutional and the practical standpoint. . . . It is inevitable that a zoning regulation permitting certain uses of land and proscribing others will adversely affect individual rights in some cases. The essential purpose of a board of appeals is to deal with these cases by furnishing elasticity in the application of regulatory measures so that they do not operate in an arbitrary or confiscatory and, consequently, unconstitutional manner."

Florentine v. *Town of Darien, supra*, 115 A.2d at 332-333. Indeed the failure to grant a variance when the owner has proved "unnecessary hardship" is an abuse of discretion, in that the spectre of confiscation of his property must be avoided. *See R-N-R Associates* v. *Zoning Board of Review*, 100 R.I. 7, 210 A.2d 653, 655 (1965).

[24] The importance of expressly guaranteeing a reasonable return is made even stronger by the "character of the governmental action" in the instant case. *See Penn Central, supra*, 438 U.S. at 124. Here, the City of San Jose has enacted a tenant hardship provision which may operate to redistribute funds from owners to economically needy tenants at the expense of the owner's reasonable return. While the provision of affordable housing to low and moderate income families is unquestionably an important public goal, its accomplishment through an exercise of the police power raises significant questions about the proper allocation of public and private responsibilities. After all, owners of housing properties have not created the affordable housing problem. *See generally Nollan* v. *California Coastal Commission*, No. 86-133 (United States Supreme Court, argued March 30, 1987); R. Babcock, ed., *Exactions: A Controversial New Source For Municipal Funds*, 50 Law and Contemporary Problems, No. 1 (Winter 1987) (discussing constitutional tests for exactions). *Cf.* Sax, Takings, Private Property and Public Rights, 81 Yale L.J. 149, 162-163 (1971).

As the Court has frequently observed, the purpose of the Just Compensation Clause is "to bar Government from forcing some people alone to bear public

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Conclusion.

The City of San Jose has sought to assure its economically needy residents affordable housing. No matter how worthy this objective — and it is one whose achievement is strongly endorsed by the Amici — it may not be constitutionally accomplished at the expense of an owner's economically viable use of property secured by the Just Compensation Clause of the Fifth Amendment. The Amici ask this Court to make clear that the Ordinance must guarantee owners economically viable use, and that the "tenant hardship" override provision is therefore unconstitutional.

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burdens which, in all fairness and justice, should be borne by the public as a whole." *Armstrong* v. *United States*, 364 U.S. 40, 49 (1960); *see, e.g., Connolly* v. *Pension Benefit Guaranty Corp., supra*, 106 S.Ct. at 1027; *Webb's Fabulous Pharmacies, Inc.* v. *Beckwith*, 449 U.S. 155, 163 (1980); *see generally*, Michelman, Property, Utility and Fairness: Comments on the Ethical Foundations of 'Just Compensation' Law, 80 Harv.L.Rev. 1165, 1214-1224 (1967). Whether or not the subsidy of economic hardship tenants "should be borne by the public as a whole," this general principle demands that owners at minimum be expressly assured that *no* redistribution can ever interfere with their ability to obtain the constitutionally-guaranteed reasonable return. The promise of fairness in the Just Compensation Clause means nothing less.

AMICUS CURIAE

BRIEF

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No. 86-753

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

RICHARD PENNELL and
TRI-COUNTY APARTMENT HOUSE OWNERS ASSOCIATION,
Appellants,

v.

CITY OF SAN JOSE and CITY COUNCIL OF
THE CITY OF SAN JOSE,
Appellees.

On Appeal from the Supreme Court of the State of California

BRIEF OF *AMICI CURIAE* THE WASHINGTON LEGAL FOUNDATION IN SUPPORT OF APPELLANTS

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On Appeal from the Supreme Court
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BRIEF OF *AMICI CURIAE* THE WASHINGTON LEGAL FOUNDATION IN SUPPORT OF APPELLANTS

INTERESTS OF *AMICI CURIAE,* THE WASHINGTON LEGAL FOUNDATION

The Washington Legal Foundation ("WLF") is a non-profit public interest law center with nationwide membership, based in Washington, D.C. WLF engages in litigation and administrative cases concerning issues which are of significant concern to its membership. The membership of WLF represents a broad cross-section of the United States and includes many who are either landlords or tenants, and all of whom share a belief in the preservation and enhancement of free enterprise as the cornerstone of our political liberties.

WLF has participated in and has devoted a substantial portion of its resources to cases relating to government regulations and constitutional law. WLF appeared as *amicus curiae* in ***Fisher v. City of Berkeley,*** 106 S.Ct. 1045 (1986), as well as numerous other cases which included issues of business or individual rights.

WLF believes that rental price control is deleterious to the local and national economy. This spreading social welfare experiment, paid for through use of the police power, has actually hurt those lower income renters for whom the alleged benefits were intended.

WLF and its membership find repugnant in particular that one legislatively selected political minority—landlords in this case—has been forced to bear the entire direct economic cost of rent control. This precedent, if not reversed, allows and encourages government to extract the cost of its social welfare experiments from other unpopular minority groups and thus avoid using lawful and appropriate, but politically undesirable, forms of general taxation.

STATEMENT OF THE CASE

In the interests of judicial economy, *amici* adopt by reference the statement of the case as set forth in the brief of the appellants.

SUMMARY OF ARGUMENT

Landlords are a numerical minority. Through a social welfare program of rent control the political majority confiscates, without just compensation, part of the value of the landlords' property.

This tyranny by the political majority violates threshold principles upon which the Fifth and Fourteenth Amendments are based. The economic burden of rent control should be appropriately borne by the general public through accepted forms of taxation.

The San Jose ordinance—taken both individually and as an ordinance representative of generally enacted rent control schemes—fails to establish any rational relationship to its intended goals of tenant protection. Such statutes are invariably based on the absurd premise that rental price control successfully protects otherwise helpless and innocent tenants from those inviolable laws of economic supply and demand.

Thus, rent control without alternative landlord compensation, and the San Jose Municipal Ordinance 19696 in particular, stand in violation of the United States Constitution.

ARGUMENT

I. RENT CONTROL CONSTITUTES A GOVERNMENTAL TAKING OF PRIVATE PROPERTY AND THUS TRIGGERS THE CONSTITUTIONAL REQUIREMENT OF JUST COMPENSATION.

A. Just Compensation Is Required When Non-Speculative Private Property Rights Are Taken To Finance A Program of Social Welfare.

As the negative economic effects of rent control have not yet overcome the misguided political power of organized tenants, it becomes necessary to examine the circumstances under which a legislature must provide just compensation to a landlord for the confiscation of that landlord's property value and rental income under the guise of legitimate police power.

The Fifth Amendment defines an absolute border through which a government may not pass without providing just compensation. The Supreme Court, in reviewing the history of this constitutional provision left no question as to its importance:

> In the case of *Sinnickson v. Johnson*, 17 N.L.J. (2 Harr.) 129, 145, cited in the case of *Pumpelly v. Green Bay Company*, 13 Wall. 166, 178, it was said that "this power to take private property reaches back of all constitutional provisions; and it seems to have been considered a settled principle of universal law that the right to compensation is an incident to the exercise of that power; that the one is so inseparably connected with the other, that they may be said to exist not as separate and distinct principles, but as parts of one and the same principle."

Monongahela Navigation Co. v. United States, 148 U.S. 312, 324 (1893). And the Court further stated that when one "surrenders to the public *something more and different* from that which is extracted from other members of the public, a full and just equivalent shall be returned to him." *Id.* (emphasis added).

It is frequently argued that the just compensation clause centers on the definition of a Fifth Amendment "taking", with emphasis falling on the type of government action (e.g., enterprise versus arbitral). But the Supreme Court has long since indicated that "without such compensation the appropriation of private property to public uses, *no matter under what form of procedure it is taken*, would violate the provisions of the Federal Constitution." *Chicago, Burlington & Co. R'D v. Chicago*, 166 U.S. 226, 239 (1896) (emphasis added). Sixty-four years later the opinion of the Supreme Court remained unchanged:

> Since this acquisition was for a public use, *however accomplished*, whether with an intent and purpose of extinguishing the liens or not, the Government's action did destroy them . . . [and] . . . did thereby take the *property value* of those liens within the meaning of the Fifth Amendment.

Armstrong v. United States, 364 U.S. 40, 48 (1960) (emphasis added). As a result, upon closer examination, the established case law actually differentiates only between the type of property taken, rather than the type of government action which constitutes a taking.

Where one case involved air space above a structure designated as a historic landmark, the Supreme Court generally agreed that something was taken from the appellants as a result of the landmark designation, but that speculative "air rights" and the denial of an "ability to exploit a property interest that [appellants] heretofore had believed was available for development" would not constitute constitutionally compensable property. *Penn Central Transportation v. City of New York*, 438 U.S. 104 (1978).

By comparison, in addressing a case where the property interest was certain liens, the Supreme Court held that those liens were an actual property value within the meaning of the Fifth Amendment and that the destruction of those liens by the government obligated the payment of just compensation for the value of the liens. *Armstrong v. United States, supra*, 364 U.S. 40 at 49.

And lastly, the condemnation of a lock and dam resulting in the loss of a franchise to collect future tolls has been held by the Supreme Court to require compensation by the United States Government for both the value of the tangible property and the value of the franchise to collect future tolls. *Monongahela Navigation Co. v. United States, supra*, 148 U.S. 312 (1893).[1] Thus even a right to collect future revenues of undetermined amount is a non-speculative compensable property value for purpose of the Fifth Amendment.

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[1] The *Monongahela* case also presents a separation of powers question to the rent control issue. The court emphasized that it would not allow the legislature to "apply the property of the citizen to the public use, and then to constitute itself the judge in its own case, to determine what is the 'just compensation' it ought to pay therefor . . ." *Id.* at 327. By not allowing for any landlord compensation whatsoever, the legislature has in effect acted in the

As it appears obvious that rent control constitutes a *prima facie* taking of something, as found in *Monongahela*, *Armstrong* and *Penn Central*, the question now presented to this Court is not "What constitutes a taking?", but rather, "For the purposes of government taking, what is compensable private property?"

These cited cases taken together indicate that the line where government action constitutes a compensable taking lies appropriately between property of mere speculative future value [not compensable] and property of actual present value or property rights having a reasonable certainty of future value [compensation constitutionally required].

This formula achieves both clarity and constitutionally consistent law. When government action requires the taking of property in execution of a policy of general public welfare, the just compensation clause is invoked whenever the property or expected revenue in question has more than mere speculative value.

When examined in the context of cited precedent, free market rental revenues on established residential properties are both an actual present value and a property right with reasonable certainty of future value. In either instance the property right exceeds the standard of mere speculative value. And therefore, the lost rental property value and the loss of reasonably expected rent revenue would indeed constitute private property which if taken by the government for purposes of the public welfare must invoke constitutionally mandated just compensation.

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capacity of the judicial branch and attempted to self-adjudicate the amount of just compensation.

B. The San Jose Ordinance Creates An Unconstitutional Extension Of Governmental Police Power.

Rent control allegedly addresses the issue of affordable housing where a jurisdiction otherwise refuses to provide an adequate, equitable and constitutionally sound system of taxpayer supported public welfare. If upheld, the underlying premises—that legislatures can take private property, without just compensation, to finance purely governmental functions—would not be contained to the one issue of rent control, but would constitute an extraordinary extension of governmental police power.

Following the precedent already established by this case, a legislature faced with the need for a system of public transportation, but unwilling to finance it out of tax revenues, could simply require that General Motors Corporation *et al.* sell their vehicles at a price below market value. Or perhaps require that all taxi cab drivers carry poor passengers for free. No public ambulance service? No problem—just pass a law requiring that private hospitals supply free transportation.

In the area of housing, a solution for the problem of society's homeless would be only a hotel away. A municipality could confiscate 20% of the rooms in any hotel (on a permanent basis and without compensation, of course) to be used by our homeless citizens. Since hotel operators happen to be engaged in the commercial business of providing temporary shelter, naturally they alone should bear the full uncompensated expense of housing transient members of the homeless community.

If not shelter then sustenance must rank at the top of society's needs. But now it is discovered, as we have fortuitously been enlightened by the Supreme Court of the State of California, that the taxpayers are throwing away money on the Food Stamp Program when a permanent national "Food Price Control Act" would have been more than sufficient. Let the farmers, distributors and supermarkets bear the cost of "food price controls" or lose their capital investments because they happen to be engaged in the commercial business of providing food.[2]

Obviously these are extreme examples, but all are well within the scope of this extremely broad lower court decision.

II. RENT CONTROL CONSTITUTES A LEGISLATIVE ATTACK ON ONE POLITICAL AND ECONOMIC MINORITY CLASS IN VIOLATION OF THE EQUAL PROTECTION CLAUSE.

If rent control advocates did not intend to create systematic wealth redistribution through uncompensated confiscation, then rent control must properly portray the pernicious product of purely political "landlord bashing" —the politicians' attempt to gain political favor by punishing one plainly unpopular demographic minority.

Landlords are indeed easy political targets. In a country that has proudly rejected political attacks based upon race, sex, and religion, it now appears quite acceptable to attack landlords for personal political gain. As a class, landlords now constitute an economically and politically persecuted minority. Rent control considered as a punitive policy of political posturing clearly violates the equal protection clause.[3]

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[2] If any American agricultural enterprises were to survive permanent food price controls, the development of a "black market" for food products would follow shortly thereafter. One need not stretch credulity to find comparable the well developed "black market" for rent controlled apartments, with all its customary bribes, nepotism and fraud, to the Soviet Union black market for food and other consumer products—each the inevitable result of a naive belief that government can repeal the laws of supply and demand.

[3] Furthermore, once any program of rent control is established, the evidence indicates that it becomes entirely entrenched. "Whatever the actual impact of rent controls, renters are likely to perceive significant benefits from them. Thus, needed changes or adjustments may be very difficult to achieve and dismantling a rent control program may be impossible." 15 Urban Institute Policy and Research Report 11 at 14 (May 1986).

And the courts have so stated that the burden of alleviating the financial and economic hardship of poor tenants must be borne by the public at large and not by individual landlords. "To charge the cost of operation of state functions conducted for the public benefit to one class of society is arbitrary and violates the basic constitutional guarantee of equal protection of the law." *In Re Gerald C.*, 36 Cal.3d 1, 6 (1984). See also, *Norwood v. Baker*, 172 U.S. 269, 279 (1898). Furthermore, *The New York Times* Editorial Board has also recognized the injustice of rent control. "Improving [tenants'] housing requires broadly based financial help, in place of the unjust—and mistaken—pretense that subsidies should come only from landlords." *The New York Times*, May 12, 1987, Section A at 30.

But who are these landlords anyway? Wealthy robber barons? Land grabbing Shylocks? Actually, it is more likely that your landlord would be a retired widowed grandmother living in Florida whose entire real estate portfolio consists of one small apartment (purchased as an "insider" tenant 20 years ago) and a funeral plot.

It should not be assumed that landowners are in better economic condition than the supposedly protected class of tenants. "In fact, individual tenants frequently have incomes which are *higher* than their landlord's and to our knowledge, no body of evidence exists which indicates that on average tenants have significantly lower incomes." R. Ault, *The Presumed Advantages and Real Disadvantages of Rent Control* reprinted in *Rent Control: Myths & Realities* at 57 (emphasis added).[4]

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[4] D. Gale Johnson investigated the issue in detail years ago and concluded, "I do not want to argue that the evidence presented indicates that landlords are poorer than tenants. But the data certainly do not indicate the contrary—that landlords have significantly higher incomes than tenants." Johnson, *Rent Control and the Distribution of Income*, 41 Amer. Econ. Rev., Papers and Pro-

III. RENT CONTROL BEARS AN INSUFFICIENT RATIONAL RELATIONSHIP TO ITS INTENDED SOCIAL WELFARE GOALS AND THUS VIOLATES THE DUE PROCESS CLAUSE.

Rent control without alternative landlord compensation attempts to violate the most basic of economic rules—Tinstaafl's Law.[5] It does not succeed. But despite voluminous research and countless studies indicating that the alleged goals of artificial rent control will never succeed, the growth of rent control legislation continues unabated.[6]

It is clear that legislative rationality must play a significant role in the determination of constitutionality.

> Price control is "unconstitutional . . . if arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt . . ."

In Re Permian Basin Area Rate Cases, 390 U.S. 747, 768-770 (1968), citing *Nebbia v. People of State of New York*, 291 U.S. 502, 539 (1934); *Birkenfeld v. City of Berkeley*, 17 Cal.3d 129 at 165 (1976). Without some rational relevant relationship to its alleged purpose of rectifying an economic imbalance in the distribution of housing resources, the policy of rent control would also stand as constitutionally flawed. But permanent peacetime rent controls—unlike the emergency measures imposed during World War I and II—remove any future incentive to produce more housing and thus merely freeze the economic imbalance without any corrective effects. D. McCloskey, *The Applied Theory of Price* at 214 (1982). Legislation so attempting to permanently alter the laws of supply and demand is obviously devoid of any constitutionally acceptable rational basis.

One authority eloquently summarized the irrationality of rent control:

> The effects of rent control have in fact been exactly what can be predicted from the simplest type of supply-and-demand analysis—"housing shortage" (excess demand for housing), black markets, privileges for those who happen to have a contract for a rent-controlled apartment, nepotism in the distribution of the available apartments, difficulties in getting apartments for families with children, and, in many places, deterioration of the housing stock. In fact, *next to bombing, rent control seems to be the most efficient technique so far known for destroying cities*, as the housing situation in New York City demonstrates.

Assar Lindbeck, *The Political Economy of the New Left: An Outsider's View* (New York; Harper & Row, 1971), p. 39 (emphasis added). And *The New York Times* has weighed in with an editorial stating, "There's probably nothing that distorts a city worse than rent regulation. It accelerates the abandonment of marginal buildings, deters the improvement of good ones and creates wondrous windfalls for the middle class—all the while harming those it

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ceedings 571 (1951). Also William D. Grampp, *Some Effects of Rent Control*, 16 Southern Economic Journal 425 at 447 (1950).

Citing Johnson, another study concluded, "One of the primary arguments used in behalf of rent control is that landlords are richer than tenants and hence rent control has a desirable *redistributive* effect. However, if rent control applies to all rental housing in a large area, it is doubtful that the landlords are significantly richer than their tenants." Edgar O. Olsen, *An Econometric Analysis of Rent Control*, Journal of Political Economy 1101 at 1099 (November 1972) (emphasis added).

[5] "Tinstaafl's Law"—There Is No Such Thing As A Free Lunch. Tinstaafl's Law has also on occasion been claimed as a rule of nuclear physics, a law of thermodynamics, and a principle of environmental conservation.

[6] Although federal rent controls were used during both world wars to deal with the effects of temporary housing shortages, peacetime controls were unknown outside New York City until the early 1970s. Since that time numerous jurisdictions—particularly in Massachusetts, New Jersey, and California—have adopted rent control. *Effects of Rent Control in Los Angeles*, Urban Institute Policy and Research Report 15 (1986). It is now believed that rent control laws have been adopted in more than 50 California cities and over 500 other communities across the country.

was meant to help, the poor." *The New York Times*, *supra*. Indeed, *amici* consider rent control to evidence the ultimate synthesis of legislative snake oil and bumper sticker logic.

It is therefore not surprising that the rent control activity mandated by the San Jose ordinance has been condemned by virtually all economists.[7] W. Block, Preface in *Rent Control: Myths & Realities* xiv (The Fraser Institute edit. 1981) (essays by sixteen economists); Rabin, *The Revolution in Residential Landlord-Tenant Law*, 69 Cornell L. Rev. 517, 555 (1984); Muth, *Redistribution of Income Through Regulation in Housing*, 32 Emory L.J. 691, 698 (1983). In fact, such near universal condemnation of rent control represents the widest consensus within the economics profession. Block, *supra*. These economists have concluded from ample empirical evidence that rent control schemes cause "serious economic dislocation." *See*, *City of Lafayette v. Louisiana Power & Light Co.*, 435 U.S. 389, 412-413 (1978). For example, Nobel Laureate economists Milton Friedman and George Stigler conclude that, "Rent ceilings, therefore, cause haphazard and arbitrary allocation of space, inefficient use of space, retardation of new construction and a future depression in residential building. Formal rationing by public authority would probably make matters worse." M. Friedman & G. Stigler, *Roofs or Ceilings? The Current Housing Problem* reprinted in *Rent Control: Myths & Realities*, at 102.

Based in part upon similar expert testimony, the President's Commission on Housing made three recommenda-

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[7] It is clear why there is such disapproval. Because the government forbids rentals above the old price, a landlord has no incentive to surrender more housing, and tenants are unable to express in money offers to landlords their new and larger willingness to pay for housing. Thus, the social welfare loss represents the sum of consumers' and producers' surplus foregone. D. McCloskey, *The Applied-Theory of Price* (1982).

tions for public policy on the question of municipal rent ceilings:

1. The Commission finds that rent control causes a reduction in the quality of existing rental housing stock and discourages investment in new rental property. Therefore, the Commission opposes, in principle, rent control at Federal, State, and local levels.
2. The adverse effects of rent control spread far beyond the boundaries of municipalities. Therefore, the Commission urges that states pass legislation removing the power of counties, cities, and all other local jurisdictions to adopt ordinances controlling rents.
3. The Commission recommends that the Federal government should preempt the application of any State or local government rent controls on rental housing financed by a lending institution . . . insured by a Federal agency, and on rental housing financed by the Federal government or which has a mortgage insured or guaranteed by the Federal government or its agencies.

The President's Commission on Housing, *The Report of the President's Commission on Housing*, 91-93 (1982). The Commission also relates that it is frequently not just the enactment of rent control that deters rental investment. "[E]ven the discussion of potential enactment can create a disincentive. Rental housing is a long-lived commitment. Investors make decisions about new construction or the rehabilitation of rental housing based upon their expectations. If investors anticipate the future enactment of rent control, even in a relatively non-binding form, it will affect their predictions about future income flows and expenses as well as their decision to invest." *Id.*

Rent control has the absolute effect of discriminating against tenants who are forced to relocate. Since new tenant rents are frequently used to partially offset landlord economic losses on older tenancies, tenants may actually find that relocation has become prohibitively expensive if not impossible. Ault, *supra* at 70. A program allegedly designed to assist the welfare of tenants, may in fact leave them economically stranded in housing of declining quality—such are the "benefits" of rent control.

Even while tenants might not all become residentially incarcerated through rent control, they are nevertheless likely to encourage a further misallocation of the existing housing stock. *Id.* This occurs when tenants are merely deterred from moving because of the increased difficulty of locating a vacant unit (a result of reduced new construction) and the loss of subsidy associated with tenure. Thus, young, growing families will be inclined to endure the crowding rather than relinquish their subsidy, while older tenants remain in larger units as their family size declines with older children leaving the home. And according to *The New York Times* Editorial Board, "Many [tenants] have stayed in their large apartments long after the children left and the dog dies because a suitable replacement dwelling, though smaller, would cost more." *The New York Times, supra.*

As implied, these harmful economic effects of rent control emanate from its negative impact on the production of housing. For example, the "fair return" approach typical of rent control statutes will invariably perpetuate the very housing shortages used to justify the legislation —a legislative solution akin to extinguishing fires through the application of gasoline.

"Fair return" destroys the signaling role that profits normally play in an economic system. Where demand for a particular product (like housing) rises, suppliers temporarily receive profits in excess of "fair" or "normal" levels. The very existence of these high profits is the inducement for an increased supply. To the extent that high profit rates are not realized, they have the effect of discouraging housing construction and perpetuating housing shortages. Ault, *supra* at 77. This point has been frequently made in public hearings and discussions. Builders and lenders virtually swore to the Regulations Committee of the President's Commission on Housing that they would never invest in rental housing construction in a community subject to rent controls, even if those controls did not apply to newly constructed housing. Siegan, *Commentary on Redistribution of Income Through Regulation in Housing*, 32 Emory L.J. 721, 723 (1983).

Data from rent control areas fully support the notion that rent control discourages housing production. In England, where strict rent controls have been in effect for over sixty years, the production of private rental housing has been at such a low level that the percentage of households living in this type of housing has dropped from 61 percent to below 15 percent. J. Brenner & H. Franklin, *Rent Control in North America and Four European Countries* 4 (1977). In New York City the number and percentage of persons living in this type of housing also declined. P. Neibanck, *Rent Control and the Rental Housing Market in New York City* 29 (1968). In Washington, D.C., with only a brief experience of rent control, the number of units available for rent fell by 8,000 units, *Washington Post*, December 12, 1977, Section A at 1, and the number of multifamily building permits fell from 7,263 in the first four months of 1976. Bureau of the Census, U.S. Department of Commerce, *Construction Reports*, Authorized Construction, Washington, D.C. Area, Series C41 (1976).

Maximum rent schemes also may be fixed too low to encourage, or even permit, landlords to furnish services or facilities deemed necessary or desirable by their tenants. See, *Albrecht v. Herald Co.*, 390 U.S. 145, 152-53 (1968). This deterioration of housing stock is well supported by research. Empirical results reported by Moorhouse, Sternlieb and RAND show that rent control does lower the level of maintenance of buildings, all other things (including age and condition) being equal. See, H. Wexler & R. Peck, *Housing and Local Government* 65 (1975).[8] Thus by promoting the deterioration of rent controlled buildings and reducing the quality of housing, rent control in another way effectively reduces the quantity of housing services available.

Rent control actually increases the cost of providing rental housing. Because the existence of rent control or the threat of its adoption has the effect of increasing the risk associated with investing in rental housing, investors will require the payment of higher interest rates as compensation. Ault, *supra* at 71. Since over 40 percent of rent revenues are used to pay debt charges, E. Achtenberg, *The Social Utility of Rent Control in Housing Urban America* (ed. Pynoos, Schafer, and Hartman) 437 (1973), a slight increase in the rate at which these buildings are financed can have a substantial impact on rent levels.

The argument in favor of rent control is further weakened when it is considered that alternative solutions are at least rationally related to the intended goals—some of which are even consistent with the free market system. Rent subsidies may be provided to needy tenants, public housing projects may create additional rental units, and property may be constitutionally acquired through negotiated purchase or compensated condemnation. *Fisher v. Berkeley, California*, 37 Cal.3d 644 (Lucas, J., dissenting) (1984), aff'd 106 S.Ct. 1045 (1986). See Grampp, *supra* at 447.

With other appropriate solutions available, rent control burdens the economic freedom of landowners with unnecessary restrictions that are not substantially or even rationally related to the accomplishment of governmental goals. For the sake of electoral longevity, politicians resort to the economically extreme measure of rent control as a casual form of housing policy. This is done without requiring the bona fide housing emergencies that existed in World War I and World War II which first gave rise to rent controls. The condition of anticipated rent increases hardly qualifies as a dire emergency. Even if such a condition were considered an emergency, the permanency of the rent control measures are unnecessary.

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[8] In New York City 29 percent of the rent controlled units are deteriorated as opposed to 8 percent of the uncontrolled units. Niebank, *supra* at 120.

CONCLUSION

Present illusions of cost free rent control have stained the fabric of urban America. Permanent rental price fixing constitutionally fails both as a rationally related remedy for limited housing resources and as a method to force exclusive landlord financing of social welfare. The San Jose City Council has galloped through the borders of constitutionally permissible economic folly and now trespasses upon sacred constitutional soil.

If our goal is to provide more housing resources, rent control is an irrational, if not bizarre, means. If the goal is to provide tenants with a certain level of government determined value for their rental dollars, then rent control fails miserably. And, if the goal is a plan of systematic wealth redistribution, then it ought to be financed out of constitutionally acceptable forms of taxation.

This San Jose rent control statute and similar statutes throughout the country represent a consistently creeping encroachment onto individual liberty and a clear defiance of sound constitutional principles. They represent an unprecedented expansion of government police power to finance a program of social welfare. And they represent the economic abuse of an unpopular numerical minority by the politically powerful majority.

For all of the foregoing reasons, *amici* submit that the decision below should be reversed.

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AMICUS CURIAE

BRIEF

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No. 86-753

IN THE
Supreme Court of the United States
OCTOBER TERM, 1986

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TRI-COUNTY APARTMENT HOUSE OWNERS ASSOCIATION,
Appellants,
v.
CITY OF SAN JOSE and CITY COUNCIL OF SAN JOSE,
Appellees.

On Appeal from the Supreme Court of the State of California

BRIEF AMICUS CURIAE OF THE COMPETITIVE ENTERPRISE INSTITUTE IN SUPPORT OF APPELLANTS

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BRIEF AMICUS CURIAE OF THE COMPETITIVE ENTERPRISE INSTITUTE IN SUPPORT OF APPELLANTS

The Competitive Enterprise Institute (CEI) hereby files this amicus curiae brief in support of the appellants in this case. Pursuant to Supreme Court Rule 36.2, letters of consent to this filing have been obtained from counsel for all parties and have been lodged with the Clerk of the Court.

INTEREST OF THE AMICUS CURIAE

CEI is a nonprofit policy analysis organization dedicated to advancing free-market solutions to regulatory issues. CEI is incorporated in the District of Columbia as a tax-exempt organization and, through its publications, forums and litigation activities, has been actively involved in such issues as risk allocation, free trade, and antitrust reform.

In CEI's view, rent control is a regulatory scheme unparalleled in the degree to which it is uniformly condemned by economists. While it is often justified as protecting the poor, they are in fact its greatest victims as the housing stock shrinks under the regulatory regime, as building maintenance first is reduced and finally gives way to outright abandonment, and as prices are driven up in the uncontrolled sector of the market.

CEI submits that the hardship provisions of San Jose's rent control ordinance must be examined in the light of these effects, which are overwhelmingly documented in the economic literature, just as the effects of separate-but-equal schooling, as set forth in "modern [psychological] authority", played a pivotal role in this Court's 1954 desegregation decision. *Brown v. Board of Education*, 347 U.S. 483, 494 & n.11 (1954). CEI files this brief in the hope of adding this perspective to the arguments presented in this case.

SUMMARY OF ARGUMENT

The hardship provisions of San Jose's rent control ordinance effectively make landlords personally responsible for the welfare of their low-income tenants. To achieve what is clearly a general social goal, the care of the needy, San Jose has imposed subsidy relationships between particular individuals based solely on the accident of who happens to be renting from whom. A scheme which so capriciously singles out people for the purpose of paying society's bills violates constitutional requirements of "rudimentary fairness in the allocation of economic burdens." *Fred F. French Investing Co., Inc., v. City of New York*, 39 N.Y. 2d 587, 600, 350 N.E. 2d 381, 389 (1976).

As an attempt to alleviate the condition of low-income tenants, San Jose's action meets the requirements of neither minimum rationality nor equal protection. In the near-unanimous opinion of economists, rent control *worsens* rather than improves housing availability, and those who suffer most as a result are minorities and the poor. At best, some low-income tenants currently living in rent-controlled units may benefit from the law's hardship provisions, but those who come looking for apartments in the future are likely to find the doors barred by the very measure that is allegedly there to help them.

ARGUMENT

I. IN ATTEMPTING TO MAKE LANDLORDS INDIVIDUALLY LIABLE FOR THE WELFARE OF THEIR NEEDY TENANTS, SAN JOSE HAS VIOLATED CONSTITUTIONAL REQUIREMENTS OF BOTH FAIRNESS AND FISCAL OVERSIGHT WITH RESPECT TO THE COSTS OF SOCIAL PROGRAMS

That aid to the needy is a proper government function is not in dispute in this case; what is at issue is the City of San Jose's attempt to place the burden of such aid upon those particular landlords who happen to have financially needy tenants. A landlord who carries such a burden is clearly forced to "surrender to the public something more and different from that which is exacted from other members of the public"; absent "full and just" compensation, such a law directly violates the constitutional prohibition against "loading upon one individual more than his just share of the burdens of government." *Monongahela Navigation Co. v. United States*, 148 U.S. 312, 325 (1892). The Fifth Amendment's requirement of compensation for takings "was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Armstrong v. United States*, 364 U.S. 40, 49 (1960).[1]

In violating this requirement of elementary fairness, San Jose's ordinance also negates the Fifth Amendment's implicit constraint on the tendency of governments to undertake spending programs. Had San Jose chosen to aid needy tenants with cash payments or rental vouchers, the cost of its program would have been clear for taxpayers to evaluate and approve or disapprove. San Jose's decision to instead place the burden of this assistance on individual landlords circumvents this check; "the ultimate economic cost of providing the [program] is hidden from those who in a democratic society are given the power of deciding whether or not they wish [it] . . . . When successfully [thus] concealed, the public is not likely to have any objection to the 'cost-free' " program. *Fred F. French Investing Co., Inc. v. City of New York*, 39 N.Y. 2d 587, 597, 350 N.E. 2d 381, 387 (1976).

For these reasons alone, as elaborated in the appellants' brief, San Jose's ordinance should be ruled invalid under the Fifth and Fourteenth Amendments. As is shown below, however, there is yet an additional basis upon which to strike this law; namely, that in light of the nearly unanimous assessment of rent control by economists, the ordinance is an irrational means of accomplishing the city's objective of assisting low-income tenants.

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[1] In *Fred F. French Investing Co. v. City of New York*, 39 N.Y. 2d 587, 350 N.E. 2d 381 (1976), the New York Court of Appeals invalidated the rezoning of private parks into public ones, holding that since this was a program to benefit the public, its costs could not fall on the basis of "the accident of ownership." *Id.* at 596-97, 350 N.E. 2d at 387. In San Jose's program to aid low-income tenants, the capriciousness of the cost imposition is *twofold*, based not only on the accident of ownership but of occupancy as well.

II. THE HARDSHIP PROVISIONS OF SAN JOSE'S ORDINANCE ARE AN ILLEGAL AND IRRATIONAL MEANS OF HELPING LOW-INCOME TENANTS; THEIR SITUATION, ALREADY WORSENED BY RENT CONTROL ITSELF, WILL DETERIORATE EVEN MORE AS THEY BECOME LEGAL LIABILITIES FOR LANDLORDS

If the City of San Jose had decided to protect its residents from the ravages of heavy rainstorms by outlawing umbrellas, its action would be stricken as an irrational attempt to defy the laws of atmospheric physics, an act not even "debatable" under the minimum rationality test of *United States v. Carolene Products Co.*, 304 U.S. 144, 154 (1938).

As will be shown below, rent control's effectiveness as a supposed remedy for housing shortages fares no better with respect to the laws of economics. In the practically unanimous view of economists, rent control worsens both the quantity and quality of the housing stock. It reduces incentives for new investment, it encourages overconsumption of existing rental space by current tenants, it creates black markets which boost effective rents above their regulated limits, and it increases the extent to which housing is distributed on the basis of such nonmonetary characteristics as race and family size. While the city may have properly found that there was "a growing shortage of and increasing demand for housing" (San Jose Ordinance No. 19696, Section 5701.2), the means it chose to address that situation will indisputably worsen these conditions.

More importantly for this case, the economic literature also demonstrates, with nearly the same degree of unanimity, that the low-income tenants whom the city sought to protect will become not the beneficiaries of the ordinance, but its victims. They, more than any other class of tenants, will suffer the most from the reduced availability of rent-controlled units and the consequently increased rents in the uncontrolled sector of the market. San Jose claims to be preventing hardship, but by categorically transforming these tenants into automatic liabilities for landlords, the city has practically guaranteed their future exclusion from the market for controlled apartments.

A. It Is the Nearly Unanimous View of the Economics Profession That Rent Control Reduces Rather Than Improves the Housing Stock

In *Hall v. City of Santa Barbara*, 797 F.2d 1493 (9th Cir. 1986), the Ninth Circuit Court of Appeals raised the possibility that rent control, as a supposed means of alleviating housing shortages, may no longer survive scrutiny under the minimum rationality standard. In that court's words, there

> "appears to be a growing consensus that 'rent control causes a reduction in the quality of the existing rental housing stock and discourages investment in new rental property,' actually exacerbating the problems it is intended to ameliorate. The Report of the President's Commission on Housing 91 (1982). *See, e.g.*, P. Samuelson & W. Nordhaus, *Economics* 393-94 (12th ed. 1985); W. Baumol & A. Blinder, *Economics: Principles and Policy* 62-64 (3d ed. 1985); Muth, [*Redistribution of Income Through Regulation in Housing*, 32 Emory L.J. 691 (1983)] at 693-98; *cf.* Frey, Pommerehne, Schneider & Gilbert, *Consensus and Dissension Among Economists: An Empirical Inquiry*, 74 Amer. Econ. Rev. 986, 988, 991 (1984) (fewer than 2 percent of United States economists surveyed at random generally disagreed with the proposition that '[a] ceiling on rents reduces the quantity and quality of housing available') . . . . The rationality of rent control *vel non* may have to be reassessed in light of this growing body of thought on the subject. *Cf. Matsushita Elec. Indust. Co. v. Zenith Radio Corp.*, [106 S.Ct. 1348, 1357 (1986)] (reexamining inference to be drawn in predatory pricing cases in light of recent law and economics commentary on the subject)." 797 F.2d at 1503 n.26.

The survey of economists cited by the Ninth Circuit was based on responses from over 200 American economists regarding 27 different propositions, ranging from free trade to labor policy. The 1.9 percent disagreement rate for the contention that rent controls reduce housing availability was the *lowest* rate recorded for any of the surveyed propositions. *See* Frey, *supra*, 74 Am. Econ. Rev. at 991-92. In the words of one economist,

> "[e]conomists who have researched [rent control's] effects are virtually unanimous in their assessment. The extent of their agreement is indicated by the remarks of the 1974 Nobel Prize winners in economics, Gunnar Myrdal and Friedrich Hayek, whose ideological views on matters other than rent control are, to say the least, quite different." Block, Preface, in *Rent Control: Myths and Realities* xiv (W. Block & E. Olsen eds. 1981).

(Myrdal is a major Swedish socialist economist while Hayek is a proponent of free markets; both oppose rent control. *Id.* at xiv-xv.)

The nearly unanimous disfavor in which rent control is held by the economics profession is based not on esoteric analyses but on such fundamental concepts as supply and demand. The profession's view of rent control is set forth not only in technical journals,[2] but in nearly every college-level economics textbook, as a sampling of the leading publications in this field indicates:[3]

> —W. Baumol & A. Blinder, *Economics—Principles and Policy* (3d ed. 1985): "Where rent controls are adopted to protect tenants, housing grows scarce because the law makes it unprofitable to build and maintain apartments." *Id.* at 5. "The objective of rent control is, of course, to protect the consumer from high rents. But most economists believe that

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[2] For a comprehensive listing of rent control literature, see R. Clatanoff, *Rent Control: An International Bibliography on Economics and Public Policy* (1985).

[3] The six books subsequently quoted above are among the eleven introductory college economics texts which "serv[e] the overwhelming bulk of the market." Taylor, Editor's Note, in *American Economic Texts* vii (J. Taylor ed. 1982); *see also id.* at iii.

rent control does not help the cities or their inhabitants and that, in the long run, it makes almost everyone worse off." *Id.* at 63.

—J. Gwartney & R. Stroup, *Economics—Private and Public Choice* 55-56 (3d ed. 1982): "Although rent controls may appear to be a simple solution, the truth of the matter is that a decline in the supply of rental housing, poor maintenance, and shortages are the inevitable results. Controls may initially lead to lower housing prices for some, but in the long run the potential for the deterioration of the quality of urban life is almost unlimited."

—R. Lipsey, P. Steiner & D. Purvis, *Economics* 104 (8th ed. 1987): "[E]ven while the supply of rental housing is shrinking [under rent control], the signal to economize on rental accommodation is *not* given through rising rentals. The housing shortage grows as the stock of rental accommodations shrinks, while nothing decreases the quantity demanded." (Emphasis in original.)

—C. McConnell, *Economics* 753 (10th ed. 1987): "At first glance the objective of rent controls—to protect tenants from the skyrocketing increases in rents caused by demand increasing faster than supply—seems laudatory. But there is rather overwhelming evidence that the actual long-run consequences tend to be much different. . . . . Rather than resolve the housing scarcity, rent controls tend to aggravate that problem!"

—R. Miller, *Economics Today* 418 (5th ed. 1985): "[T]he long-run consequences of [rent control] in New York have been a decay in the housing stock and a decline in the amount of available space for middle- and lower-income tenants . . . ."

—P. Samuelson & W. Nordhaus, *Economics* 394 (12th ed. 1985): "At the controlled rental price, there is a large group of buyers who cannot find an apartment. People hang on to too-large apartments because they are cheap. Non-price rationing occurs, as people have to bribe landlords or pay enormous security deposits to obtain a rental apartment. New building—along with maintenance and upgrading of existing rent-controlled dwellings—suffers. . . . . In the wry words of one European critic, 'Nothing is as efficient at destroying a city as rent controls—except for bombing.' "

There appears to be little difference between economists' assessment of rent control as means to improve housing, and physicists' assessment of an umbrella prohibition as a means of stopping rainfall. The wisdom of each is simply not open to informed debate.

B. The Economic Literature on Rent Control Demonstrates That Low-Income Tenants Will Be Worse Off Under San Jose's Law

The general worsening of the housing shortage will not be the only effect of San Jose's ordinance. The low-income tenants whom the law is supposed to benefit will especially suffer for two other reasons: 1) under rent control they will be even more disadvantaged than they currently are in obtaining rental units; and 2) in addition, San Jose's forced subsidy provision will create yet another handicap for them.

The primary reason for this involves what is known as "nonprice discrimination". When price ceases to be the means by which apartments are allocated, then the nonmonetary characteristics of tenants, such as their race or family size, assume major importance in determining who gets which, if any, unit. Just as the economic literature is nearly unanimous on rent control's worsening of housing shortages, so that same literature consistently describes nonprice discrimination as another major result of such laws. In the words of one textbook,

> "[N]onprice rationing of rental units will become more prevalent, and this will work to the disadvantage of some tenants. In any market where price is not allowed to ration the available quantity among competing consumers, supply will not equal demand, and some other way of determining who gets the good and who doesn't must arise. . . . . Since there

> are many more potential tenants than dwelling units, landlords can be highly selective. For example, they are likely to favor families without children or pets (children and pets increase maintenance and repair costs) and families with histories of steady employment at good wage rates (who can be counted on to pay on time). In general, potential tenants with characteristics that make them good tenants in the eyes of landlords are likely to fare relatively better than others when price rationing is suppressed." E. Browning & J. Browning, *Microeconomic Theory and Applications* 280 (1983).

See also Gwartney & Stroup, *supra* at 55 (landlords "will favor friends, persons of influence, and those with life-styles similar to their own. In contrast, applicants with many children, unconventional life-styles, or perhaps dark skin will find fewer landlords who cater to their personal requirements."); Miller, *supra*, at 417; *Hall*, 797 F.2d at 1501-02 n.23.

In New York City, which has probably the longest experience of any American city with such regulations, the

> "connection between rent controls and manifestation of greater discrimination by personal characteristics is exemplified . . . . Perhaps no city is so beset with complaints of shortages, racial discrimination, personal favors, and rundown conditions in rent-controlled apartments . . . ." A. Alchian & W. Allen, *University Economics* 103-04 (3d ed. 1972).

Nonprice competition is an area in which low-income people are at a clear disadvantage. They are frequently members of minority groups, their families are often large, and their ability to pay rent on time is often under suspicion. Under Washington, D.C.'s rent control, for example,

> "those with 'preferred characteristics' [are] whites, people without children or pets, or people who pay under the table. Washington's transient government population has every advantage to get controlled apartments because they excel in those forms of nonprice competition on the basis of which landlords choose tenants under rent control. Conversely, low income blacks in the District have no chance at all in such competition. . . . . Thus, rent control has caused precisely what it was initially designed to prevent—low and moderate income tenants are being squeezed out of the city by the very laws that were intended to protect them." Johnson, *Kicking the Poor: The Impact of Rent Control in Washington, D.C.*, J. Contemp. Stud., Spring 1981, at 23, 27.

The fact that many of the urban poor are relative newcomers creates yet another disadvantage:

> "The continuation of rent controls in New York City has been justified primarily by a desire to help poorer residents. Yet many Negro and Puerto Rican residents have been hurt by these controls because they moved to the city after controls were imposed and hence did not have 'squatters' rights to controlled apartments." G. Becker, *Economic Theory* 108 (1971).

Even for those poor with "squatters'" rights, the types of buildings that they frequently inhabit will usually be more vulnerable to the reduction in maintenance that often occurs under rent control:

> "This is less damaging to brand new buildings than to older buildings which require more upkeep to avoid becoming slums. Since low income people are more likely to live in older buildings, they are most likely to find their homes become unheated slums with uncorrected building hazards. In the extreme, they may find the building totally abandoned by the landlord . . . ." T. Sowell, *Knowledge and Decisions* 179-80 (1980).

As for those poor who are forced to seek housing in uncontrolled units, the rents they pay will be higher *because* of rent control. As a recent analysis of Los Angeles rental data concluded, "under most conditions, rent controls with exemptions cause the rental price on uncontrolled units *to exceed the equilibrium price in the absence of controls.*" Fallis & Smith, *Uncontrolled Prices* *in a Controlled Market: The Case of Rent Controls*, 74 Am. Econ. Rev., Mar. 1984, at 193, 199 (emphasis added). In the words of a Senate committee report, "there is no evidence to show that rent control benefits the poor. Quite the contrary, it helps a small, privileged group of long-time residents, largely middle class, while driving up rents in uncontrolled units." S. Rep. No. 900, 94th Cong., 2d Sess. 14 (1976).[4]

C. By Handicapping Low-Income Prospective Tenants In Order To Questionably Benefit Current Low-Income Residents, San Jose Violates the Requirements of Equal Protection and Rationality

Both the majority and the dissenting opinions in the decision below recognize that the provisions regarding low-income tenants could well end up hindering rather than helping them:

> "Landlords, who will have a great deal to lose by renting to economically marginal tenants, hereafter will carefully screen potential tenants to assure themselves of remaining entitled to a fair return on their properties. It is ironic that in upholding this unconstitutional ordinance the majority accede to a counterproductive result." *Pennell v. City of San Jose*, 42 Cal. 3d 365, 377, 721 P.2d 1111, 1120 (Mosk, J., dissenting).[5]

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[4] The emergence of condominium conversion as a means of escaping rent control presents low-income tenants with yet another regulation-created obstacle to affordable housing. *See, e.g.*, Seneker, *Let Them Eat Condos*, Forbes, Aug. 4, 1980, at 42.

That San Jose's rent control scheme singles out the poor for special protection appears to be part of the general pattern of how price controls are justified. They "are almost always rationalized, at least in part, as a desire to help the poor, yet it is remarkable how frequently they harm the poor." Becker, *supra*, at 108.

[5] For an example of the lengths to which rent-controlled landlords go in screening prospective tenants, see *Kramarsky v. Stahl Management*, 92 Misc. 2d 1030, 1031 (N.Y. Sup. Ct. 1977) (landlord's refusal to rent to lawyer out of concern that the latter would be too "attuned to her legal rights").

The majority opinion, while recognizing the possibility that "affordable housing for such persons [might thus become] even more scarce", held that this factor affected only the wisdom of the provision, not its rationality. *Id.* at 370 n.7, 721 P.2d at 1115 n.7.

This cavalier treatment, however, overlooks major issues of both logic and equal protection. The law's hardship provisions *cannot avoid* reducing substantially the housing opportunities of those low-income individuals in need of rental units. The circumstances under which such people will not suffer in their search for housing are unimaginable. At best, the provision benefits *only* those low-income tenants who are *currently* housed; it does so, moreover, only for so long as they stay in their current controlled units. Once they start to seek other quarters, they will be as handicapped as everyone else in their class.

There is no evidence to suggest that the city council intended to benefit only this one group of low-income tenants, let alone at the expense of other needy people. The means which the council chose to accomplish its goal of aiding low-income tenants is simply incapable of working and should be stricken on this basis.

There is, moreover, a serious equal protection problem regarding the actual distribution of the hardship provisions' benefits and costs. The benefits will go only to established residents, while the costs fall on future low-income tenant-applicants. (The "future", in this case, actually began when the ordinance took effect, if not even earlier when the likelihood of its enactment became known, since that is when landlords would have begun to adjust their behavior.)

Such a distribution of housing benefits and penalties serves no legitimate purpose. It is analogous to the "fenc[ing] out" of new indigents which this Court disapproved in *Shapiro v. Thompson*, 394 U.S. 618, 631 (1969), as well as the reward for past residency invalidated in *Zobel v. Williams*, 457 U.S. 55 (1982). For this reason, no less than the other grounds set forth above, the hardship provisions should be stricken.

CONCLUSION

The hardship provisions of San Jose's rent control law comport with neither due process, equal protection, nor minimum rationality. They impermissibly impose the full costs of San Jose's aid to needy tenants on a few capriciously chosen landlords. Their only effect on the dire straits into which rent control casts the poor is to worsen their situation, handicapping them further in the non-price competition at which they are already disadvantaged. That some currently-housed low-income residents may be temporarily benefitted by the hardship provisions cannot justify the penalties which will befall those who will seek housing in the future.

For these reasons, San Jose's rent control hardship provisions should be invalidated as contrary to the United States Constitution.

Respectfully submitted,

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AMICUS CURIAE

BRIEF

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No. 86-753

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

RICHARD PENNELL and
TRI-COUNTY APARTMENT HOUSE OWNERS ASSOCIATION,
Appellants,
v.

CITY OF SAN JOSE and CITY COUNCIL OF
THE CITY OF SAN JOSE,
Appellees.

On Appeal from the California Supreme Court

~~MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE AND~~ BRIEF OF THE NATIONAL MULTI HOUSING COUNCIL AS AMICUS CURIAE IN SUPPORT OF APPELLANTS

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On Appeal from the California Supreme Court

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE

Pursuant to Supreme Court Rules 36 and 42, the National Multi Housing Council ("NMHC") respectfully moves this Court for leave to file this brief as amicus curiae in support of appellants. Counsel for appellants have consented to the filing of this brief, by letter which has been lodged with the Clerk of the Court. Counsel for appellees have not consented.

The National Multi Housing Council is a nationwide organization representing developers and owners of rental housing. NMHC has several thousand members engaged in all aspects of the development and operation of rental housing, including the financing, building and management of such properties. Together, its members are responsible for hundreds of thousands of rental units. One of NMHC's principal goals is the elimination of rent control laws that create disincentives to both the building and preservation of rental housing.

The specific rent control provision challenged in this case is particularly onerous. The San Jose Rental Dispute Mediation and Arbitration Ordinance subjects rent increases in excess of 8 percent per year to review by a municipal hearing officer to determine their reasonableness. In most respects, the San Jose Ordinance is similar to the more than 200 rent control laws still in effect around the country, strictly limiting additional rent increases based on a complicated series of factors relating to the cost of providing and maintaining the rental property. However, San Jose also authorizes hearing officers to restrict rent increases based *solely* on a tenant's financial circumstances.

This unprecedented "tenant hardship" provision makes a tenant's economic circumstances the paramount factor in assessing the return an owner can obtain on his rental property. Unlike other rent control laws, the provision divorces the minimum lawful return an owner can obtain on his rental property from the costs incurred in providing and maintaining that property. In so doing, the tenant hardship provision transforms rent control from a limited regulatory program to prevent excessive rents to a supplemental income program for poor tenants, to be financed exclusively by a limited class of rental property owners. Because this case may constitute a significant precedent for the imposition of similar controls in other communities, NMHC, as an association of developers and owners of rental housing, has a substantial interest in its outcome.

NHMC also is particularly well suited to describe for the Court the economic consequences of the challenged rent control provision. As described in the accompanying brief, there no longer is any serious question that rent control is an ineffective housing policy or that it actually harms low-income tenant groups. In particular, low-income groups tend to be "screened out" of rent-controlled markets by owners who use non-price factors such as income and creditworthiness to choose from among large pools of potential tenants. The tenant hardship provision exacerbates this harm by subjecting only those owners who rent to low-income tenants to its additional rent restrictions.

A closely divided California Supreme Court rejected appellants' claim that the tenant hardship provision violates both the Equal Protection and Due Process Clauses. Petitioner NMHC believes that the three dissenting Justices, and the two lower state courts that found the provision unconstitutional, correctly concluded that the tenant hardship provision takes private property for public use. NMHC also believes that the legislative classification established by the provision is arbitrary and not rationally related to the purpose of preserving adequate and affordable housing for low-income groups, and therefore violates the Equal Protection Clause.

The San Jose Ordinance also violates the Takings Clause to the extent it impairs the right of rental property owners to repossess rental property and to withdraw from the rental market in response to the tenant hardship provision. As rental property owners subject to such "no-eviction" provisions, NMHC's members have a particularly strong interest in this issue, which has not been briefed in the courts below by any of the other parties to this litigation.

Accordingly, petitioner NMHC requests leave to file the accompanying brief as amicus curiae in support of appellants.

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QUESTIONS PRESENTED

1. Whether a municipal rent control ordinance that denies property owners a reasonable rate of return on investment in order to subsidize low-income tenants violates the Equal Protection Clause of the Fourteenth Amendment or is a taking of private property for a public use without just compensation in violation of the Takings Clause of the Fifth Amendment?

2. Whether a municipal rent control ordinance that prevents property owners from withdrawing from the rental property market in response to confiscatory rent control constitutes a taking of private property without just compensation in violation of the Takings Clause of the Fifth Amendment?

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1986

No. 86-753

RICHARD PENNELL and
TRI-COUNTY APARTMENT HOUSE OWNERS ASSOCIATION,
Appellants,
v.
CITY OF SAN JOSE and CITY COUNCIL OF
THE CITY OF SAN JOSE,
Appellees.

On Appeal from the California Supreme Court

BRIEF OF THE NATIONAL MULTI HOUSING COUNCIL AS AMICUS CURIAE IN SUPPORT OF APPELLANTS

INTEREST OF AMICUS CURIAE

The National Multi Housing Council ("NMHC") is a nationwide organization representing developers and operators of rental housing. NMHC has several thousand members engaged in all aspects of the development and operation of rental housing, including the financing, building and management of such properties. Together, its members are responsible for hundreds of thousands of rental units. One of NMHC's principal goals is the elimination of rent control laws that create disincentives to both the building and preservation of rental housing.

Because NMHC believes the benefits of rent control are illusory while the costs are real and substantial, it has vigorously opposed all forms of rent control. The specific rent control provision challenged in this case is particularly onerous. By restricting the lawful return on investment to owners of rental property based solely on the ability to pay of particular tenants, this unprecedented provision converts rent control into a supplemental income benefits program. Accordingly, NMHC has a strong interest in this case, which may constitute a significant precedent for the imposition of similar rent controls in other jurisdictions.

STATEMENT OF THE CASE

In 1979, the City Council of San Jose, California, adopted rent controls in response to an alleged "growing shortage" of housing and to "prevent excessive and unreasonable rent increases [and] alleviate undue hardship upon individual tenants." San Jose Rental Dispute Mediation and Arbitration Ordinance (the "San Jose Ordinance") § 5701.2. In most respects, the San Jose Ordinance is similar to the more than 200 rent control laws still in effect around the country. These ordinances generally seek to prevent excessive rents by strictly limiting rent increases based on specified factors relating to the income, expenses, rental history and condition of the rental property involved. Similar provisions in the San Jose Ordinance limit the ability of rental property owners to obtain rents in excess of 8 percent per year. *Id.* § 5703.28(c).

The San Jose Ordinance goes even further, however, by authorizing municipal hearing officers to restrict otherwise permissible rent increases based solely on a tenant's financial condition. Section 5703.29 provides that "[a]ny tenant whose household income and monthly household expenses meets [specified] criteria *shall* be deemed to be suffering under financial and economic hardship which *must* be weighed in the Hearing Officer's

determination."[1] The California Supreme Court recognized that this unique provision gives "potentially overriding weight" to a tenant's economic circumstances.[2] In other words, the economic status of the tenants may be the paramount factor in assessing the return an owner can obtain on his rental property.

Appellants, who are owners of residential rental properties in San Jose, filed a complaint in Santa Clara County Superior Court, challenging the tenant hardship provision as a violation of their Fifth and Fourteenth Amendment rights under the United States Constitution and analogous provisions of the California Constitution. The Superior Court agreed and enjoined enforcement of the challenged rent control provisions, declaring that the San Jose Ordinance unconstitutionally obliges private parties to assume a public burden.

The California Court of Appeals subsequently affirmed this judgment, but was reversed by a closely divided California Supreme Court. *Pennell v. City of San Jose*, 201 Cal. Rptr. 728 (Cal.Ct.App. 1984), *rev'd*, 42 Cal. 3d 365, 721 P.2d 1111 (1986). In dissent, three Justices squarely found that the "uneven treatment [resulting from the hardship provision] amounts to a forced subsidy imposed on the landlord in violation of the due process clauses of the United States and California Constitutions, which prohibit the taking of property without just compensation." *Id.* at 1119.

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[1] San Jose Ordinance § 5703.29 (emphasis added). Section 5703.29 specifically refers to criteria established by the Housing Assistance Payments Program under Section 8 of the Housing and Community Development Act of 1974, 42 U.S.C. § 1437f (1976). Regulations implementing Section 8 generally provide that families whose income is less than 80 percent of the median family income in an area qualify for assistance.

[2] *Pennell v. San Jose*, 42 Cal.3d 365, 721 P.2d 1111, 1114 (1986).

SUMMARY OF ARGUMENT

A recent editorial in the New York Times calling for an end to rent control in New York succinctly describes its failures as a housing policy:

> There's probably nothing that distorts a city worse than rent regulation. It accelerates the abandonment of marginal buildings, deters the improvement of good ones and creates wonderous windfalls for the middle class—all the while harming those it was meant to help, the poor.[3]

That rent control is an ineffective and often counterproductive housing policy no longer is open to serious question. In the more than 200 communities that nevertheless impose rent controls, both low-income tenants and the owners of rental property pay a heavy price. While owners are deprived of a fair return on their investment, tenants and potential tenants face an often precipitous decline in the quantity and quality of available housing. Because owners tend to rely on non-price factors such as creditworthiness in selecting among potential tenants in a rent-controlled market, low-income groups are disproportionately harmed by rent control.

However, even these harmful consequences pale in comparison to the impact of the tenant hardship provision on low-income tenants. By making a tenant's income the critical factor in setting rent controls, the provision in effect penalizes owners who rent to low-income tenants, thereby imposing a virtually impenetrable barrier to access. It is difficult to imagine a more effective means of excluding low-income tenants from available rental housing, particularly in middle-class neighborhoods.

The threshold constitutional question raised in this case is whether this perverse policy is so irrational that it violates the Equal Protection Clause. Although state officials ordinarily are accorded wide latitude in fashioning economic legislation, they "may not rely on a classification whose relationship to an asserted goal is so attenuated as to render the distinction arbitrary or irrational." *City of Cleburne v. Cleburne Living Center*, 473 U.S. 432, 105 S.Ct. 3249, 3254 (1985). If ever economic legislation warranted invalidation under the Equal Protection Clause, this is such a case. While the goal of providing adequate and affordable housing to low-income tenants is an important and legitimate one, San Jose's adoption of the tenant hardship provision cannot under any conceivable circumstances be said to further that goal.

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[3] N.Y. Times, May 12, 1987, at A30 ("End Rent Controls").

Experience has shown that the democratic process simply does not work when it comes to rent control in local communities. Because the immediate cost of this flawed policy must be borne only by a small minority of "deep-pocketed landlords"—and, of course, low-income tenants—it is unlikely ever to be rectified through the political process. That the San Jose Ordinance provides substantial short-term subsidies to the middle class further diminishes this prospect. While NMHC does not question San Jose's power to subsidize the middle class, regardless of whether it makes sense to do so, the cost of that policy must be shared by the community as a whole or, if the burden falls unevenly on a limited number or class of persons, the imposition of a disproportionate burden must be rationally related to the stated goal.

The tenant hardship provision also violates the Takings Clause by imposing what is quintessentially a public burden on private parties. By separating the lawful return on investment in rental property from the costs of providing that property, the provision converts rent control into a direct tenant subsidy program, with the cost of the subsidy to particular tenants borne by specific owners. The Takings Clause bars San Jose from forcing rental property owners to bear this burden which, in all fairness, should be borne by the community as a whole.

San Jose also has violated the Takings Clause by impairing the repossessory rights of owners. As in an increasing number of rent control laws, the San Jose Ordinance seeks to stem the disinvestment that follows rent control by restricting the ability of owners to withdraw from the rental market. To this end, the San Jose Ordinance expressly prohibits repossession of rental property in response to the tenant hardship provision. This radical restriction constitutes a "physical" taking, which under established law is *per se* unconstitutional.

ARGUMENT

I. THE TENANT HARDSHIP PROVISION VIOLATES THE EQUAL PROTECTION CLAUSE.

A. The Tenant Hardship Provision Is Not Rationally Related to Protecting Low-Income Tenants.

1. *The tenant hardship provision represents a significant departure from other rent control laws.*

Modern rent control practices have their origin in the "emergency" wage and price controls imposed nationally by the federal government during World War II. The Emergency Price Control Act of 1942 empowered the Administrator of the Office of Price Administration to control the maximum prices of nearly all goods and services sold throughout the United States, including rental property. Pub. L. No. 421, 56 Stat. 23 (1942). These price controls, which were designed to prevent rent profiteering, were short-lived, lasting only as long as the wartime conditions that had spawned them.

With the expiration of federal war-time rent controls, New York City was virtually the only American city to adopt local rent controls until the 1970's.[4] New York

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[4] While a number of other cities had enacted rent controls after World War I, virtually all were short-lived and many were later invalidated for lack of authority or on the ground that the war-time emergency on which they were based had passed. *See, e.g., Ambassador East, Inc. v. Chicago*, 399 Ill. 359, 77 N.E.2d 803 (1948); *Tietjens v. St. Louis*, 222 S.W.2d 70 (Mo. 1949); *Heubeck v. Baltimore*, 205 Md. 203, 107 A.2d 99 (1954); *Burton v. Hartford*, 144 Conn. 80, 127 A.2d 251 (1956); *Wagner v. Newark*, 24 N.J. 467, 132 A.2d 794 (1957). For a discussion of rent control during this period, see B. Friedlander & A. Curreri, *Rent Control: Federal, State and Municipal* (1950).

City enacted its own rent control law shortly after the war-time freeze was lifted, for the stated purpose of protecting returning veterans from excessive rents in a tight rental market. Although originally conceived of as a "temporary" emergency measure, rent control in New York City evolved into a permanent fixture. From 1942 to 1970, New York maintained restrictive rent control, virtually freezing rents. This, by all accounts, greatly accelerated private disinvestment from the City's housing market and contributed substantially to the housing disasters in the South Bronx and Harlem, as well as elsewhere in the City.[5]

In the early 1970's, the combination of student activism and rising inflation led to the adoption of rent controls in a number of states around the country. California, New Jersey, and Massachusetts enacted "local option" laws, authorizing municipalities to enact localized rent controls. By 1981, more than 100 communities in New Jersey alone had enacted some form of rent control legislation. California also proved to be fertile ground for rent control, with San Jose only the most recent of the many jurisdictions restricting the return on rental properties. During the early 1970's, rent controls also were enacted in Connecticut, Maryland, Florida and the District of Columbia.

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[5] A 1970 Rand Institute study concluded that "by preventing rents from rising in step with the costs of supplying rental housing, [New York's rent control program] has left owners with few alternatives to undermaintenance and reduction of building services." I. Lowry & M. Teitz, *Rental Housing in New York City, New York* (Rand Institute and McKinsey Co. 1970).

It soon became clear, however, that rent controls were not workable and often counterproductive, and state governments began to rein in the authority of localities to establish rent control laws. Massachusetts repealed its local option law in 1974, after only five cities and towns had enacted rent control ordinances. Florida enacted legislation sharply limiting the power of municipalities to adopt rent controls by requiring as a predicate to controls a court finding of a "housing emergency" and by limiting such controls to units renting for less than $250 per month, to ensure that any benefits were confined to the truly needy. Rent control in New Jersey also was dealt a setback by the New Jersey Supreme Court's decision in *Property Owners Ass'n v. Township of North Bergen*, 74 N.J. 327, 378 A.2d 25 (1977), invalidating as confiscatory a rent control ordinance that limited property owners to a 10 percent rent increase per annum.

Today, approximately 200 communities continue to have some form of rent control. Virtually all are located on the East and West Coasts, where rental units make up an important part of the market. These rent control provisions, the constitutionality of which has never been reviewed by this Court, differ in two significant respects from their World War II and New York City antecedents. First, rent control no longer is seen as a temporary expedient necessary to address specific emergency circumstances. Modern rent controls have become permanent regulatory fixtures, supported by *pro forma* references to "housing emergencies" that never seem to end.[6] Second, in response to the concerns raised in *North Bergen* that rent controls may be unconstitutionally confiscatory, these

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[6] San Jose's cavalier assertion of a housing emergency typifies this modern form of rent control. The Ordinance states, without elaboration, that "[i]t is found and declared that there is a growing shortage of and increasing demand for housing in the City of San Jose." San Jose Ordinance § 5701.2. Nowhere is there any indication of factual support for these "findings" or even an allegation that rents have been excessive in San Jose.

newer "moderate" rent controls contain various formulas intended to provide for annual adjustments to compensate property owners for escalating costs and to "guarantee" that rental property owners receive a "fair return."[7]

In practice, "moderate" rent controls have differed little from their predecessors and have failed to slow the disinvestment in rental housing, described below, that invariably follows the imposition of rent control. The frustrated response of an increasing number of communities, including San Jose, has been to seek to prevent disaffected owners from withdrawing their property from the rental market—principally through severe restrictions on the power of owners to evict tenants.[8]

In addition, to counter the now well-documented argument that rent control harms low-income tenant groups, San Jose adopted its "tenant hardship" provision. This unprecedented provision essentially divorces the lawful return on rental units from the cost of providing or maintaining those units, and in so doing completes the transformation of rent control from a narrow regulatory program to prevent excessive rents in time of crisis to a comprehensive supplemental income program, to be paid for by individual owners. Because owners are perceived as "deep pockets" and represent an insignificant minority, tenant hardship provisions are likely to receive wide acceptance should the San Jose provision withstand judicial scrutiny.

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[7] The San Jose Ordinance claims as one of its goals the "assurance of a fair and reasonable return on the value of the [rental] property." *See* San Jose Ordinance § 5703.28(c). This "guarantee" of 8 percent is actually lower than the 10 percent return found to be confiscatory in *North Bergen*. While the San Jose Ordinance permits additional rent increases above the 8 percent cap, such increases are not guaranteed and must be authorized by a municipal hearing officer.

[8] This provision is addressed in detail *infra* at 25-28.

2. *Restricting rents based on a tenant's ability to pay exacerbates the adverse economic consequences of rent control.*

Economists who have researched the effects of rent control are virtually unanimous in their condemnation of it as bad housing policy.[9] They have found that rent control, irrespective of the criteria used to restrict rents, leads to undermaintenance and abandonment of existing rental housing and a reduction in investment in and construction of new rental housing. Moreover, these effects are most detrimental to low-income tenants.[10]

The criticism of rent control is so universally shared by economists that rent control often is cited by textbook writers as a paradigm of the harm governmental interference can have on the operation of a competitive

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[9] *See* Frey, "Consensus and Dissension Among Economists," 74 Am. Econ. Rev. 986, 987-91 (1984); *Rent Control, Myths and Realities: International Evidence of the Effects of Rent Control in Six Countries* (hereafter, "Rent Control, Myths and Realities") (W. Block & E. Olsen ed. 1981); *Resolving the Housing Crisis: Governmental Policy, Decontrol, and the Public Interest* (M. Johnson ed. 1982); C. Baird, "Rent Control: The Perennial Folly" (Cato Public Policy Research Monograph No. 2, 1980); P. Salins, *The Ecology of Housing Destruction* (1980). J. Moorhouse, "Optional Housing Maintenance Under Rent Control," 39 Southern Econ. J. 104 (1972); G. Sternlieb, *The Urban Housing Dilemma* (City of New York Housing and Development Admin. 1972).

[10] Criticism of rent control has not been limited to economic conservatives such as Freidrich Hayek and Milton Friedman, both Nobel Laureates in economics, *see Rent Control, Myths and Realities, supra* note 9 pp. 87, 172, but also has come from prominent liberal economists (such as Gunnar Myrdal, also a Nobel Laureate. Dr. Myrdal, who has been described as "an important architect of the Swedish Labor Party's welfare state," has argued that "[r]ent control has in certain western countries constituted, maybe, the worst example of poor planning by governments lacking courage and vision." S. Rydenfelt, "The Rise, Fall, and Revival of Swedish Rent Control," *Rent Control, Myths and Realities, supra* note 9, at 201, 224.

market.[11] In a competitive market, rent will represent the price at which the supply of housing that property owners are able and willing to provide equals the amount tenants are able and willing to purchase. Fluctuations in demand or supply will be met by changes in rents which, over time, induces the market changes necessary to return to equilibrium. If rents in an undersupplied market rise and housing rentals yield profits greater than in other markets, investment capital will flow into residental construction and the supply of rental housing will gradually increase through new construction, rehabilitation and conversion, until the shortage of housing (and any "excess" rents) have been eliminated. Conversely, relatively low rents—or rents artificially reduced by local governments—will diminish production of rental housing and induce disinvestment by existing suppliers.

Communities that enact rent control laws generally do so in response to perceived undersupply of rental housing and "excessive" rents. However, by disturbing the operation of the market, rent control merely exacerbates the problem of housing shortages. By forcing rents below the level established in an unregulated market, rent control reduces the profitability of rental housing, directing investment capital out of the rental market and into other more profitable markets. Communities that impose rent controls suffer often crippling declines in new rental housing construction;[12] they lose existing housing to condominium and cooperative conversions and, in some cases, to abandonment; and the quality of the remaining housing stock deteriorates as owners forego unnecessary maintenance.[13]

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[11] *See, e.g.*, W. Baumol & A. Blinder, *Economics: Principles and Policy* 64-69 (2d ed. 1982); C. McConnell, *Economics: Principles, Problems and Policies* 715-16 (8th ed. 1981); P. Samuelson, *Economics* 396-97 (11th ed. 1980).

[12] Studies have shown, for example, that privately-financed housing construction dropped by 67 percent between 1971 and 1973 in Boston, Massachusetts in response to rent control, while cities without rent control registered a significant increase in such construction. G. Sternlieb, *The Realities of Rent Control in the Greater Boston Area*, Center for Urban Policy Research (Rutgers Univ.

These effects occur whether rent levels are restricted based on cost factors or a tenant's financial circumstances, but are particularly acute where—as under the challenged tenant hardship provision—owners are not even guaranteed a return on their costs. Further, although the decline in quality and quantity of rental housing is felt by all existing and potential tenants, low-income tenants bear the brunt. To the extent owners are unable to discriminate among potential tenants by price, all rent controls place a premium on non-price factors such as creditworthiness, which tends to bias the tenant selection process against low-income tenant groups. The tenant hardship provision, however, is even more perverse. By penalizing owners with low-income tenants —only those owners with low-income tenants are subject to the provision—the provision virtually compels owners to screen out such tenants.

The only beneficiaries of rent control—aside from owners of uncontrolled rental units whose units become more valuable as the supply of rental stock drops—are those tenants lucky enough to find themselves in a rent controlled unit. However, even these tenant benefits do not come without a price, for the mobility of these tenants is substantially reduced by their reluctance to part with the rent control subsidy. For those in search of rental housing, the entry costs—or barriers in the case of many low-income tenants—such as finder's fees also significantly diminish the net benefits of a controlled rent.

Why then do communities enact rent controls? One recent study of rent controls in Berkeley and Santa Monica, California, entitled "Who Benefits from Rent Controls?," convincingly demonstrates that rent control often is a "political expedient," "[p]assed by a majority of middle-class voters who clearly promote their self-interest, but under the fabrication that they [are] responding to a 'housing crisis.' "[14] Among the study's principal findings were that the beneficiaries of rent con-

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1973). A study of the impact on rent control in Washington, D.C. by the Urban Land Institute similarly found that multifamily housing construction declined by 92.4 percent in response to the imposition of rent control. Urban Land Institute, *Projects for Rental Housing Production Under Rent Control: A Case Study of Washington, D.C.*, Research Report (No. 240). Similarly, a 1983 survey of major financial institutions, accounting for several hundred billion dollars in investment funds, found that rent control—and even the threat of rent control—was the major disincentive to investment in rental housing in California and that fully 56 percent of the survey respondents who had invested in California within the preceding five years were unlikely to consider lending funds in any community with rent controls. Bay Area Council Nationwide Survey of Leaders on California's Rental Housing Climate (April 6, 1983).

[13] The reasons for disinvestment are obvious. As one author noted, based on a series of case studies and the accumulation of extensive empirical evidence:

> When it is not feasible or possible to raise rents in proportion to cost increments, the only option open to owners is an internal reallocation of the rent dollar. This usually results in the reduction or deferral of maintenance expenses.

M. Lett, *Rent Control* 151 (1976). The response of rental property owners to more than 40 years of rent controls can be seen in New York City's dilapidated and deteriorated housing stock. Between 1960 and 1968, the dilapidated housing inventory increased in New York City by 44 percent and the deteriorated stock by 37 percent. E. Achtenberg, "The Social Utility of Rent Control," *Housing Urban America* 445 (J. Pynoos ed. 1973). By 1968, fully 29 percent of all rent controlled units were dilapidated; this was true of only 8 percent of the uncontrolled rental housing stock. *Id.*

[14] R. Devine, "Who Benefits From Rent Controls?" 71-72 (Center for Community Change 1986). The study found no support for either city's allegation of a housing emergency. Vacancy rates had not changed significantly in the ten years preceding rent control and "space consumption in each city was rather lavish." *Id.* at 33-34.

trol are "predominantly white, well-educated, young, professionally employed and affluent," [15] and that rent control had substantially increased the disposable income of these tenants while "exacerbating" the problems of low-income tenants.[16]

The frank admission by an architect of the Berkeley rent control law, offered in a letter to the Wall Street Journal, confirms the study's conclusion that rent control is, at best, an expensive middle class subsidy program:

> I might add that Berkeley's rent controls, in existance for seven years, have produced some unanticipated benefits for the city's retail and restaurant trade. Many of these businesses have experienced remarkable growth since the advent of rent control. Their success is [in] no small part due to the millions of dollars Berkeley tenants have gained in disposable income as a result of moderate rent levels.[17]

Like Santa Monica and Berkeley, San Jose is a relatively affluent community. Median family income in San

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[15] In Santa Monica, only 9.9 percent of the population was classified as poor in 1980. *Id.* While the figure was higher for Berkeley, "[i]t was the presence of approximately 28,000 university students" that give the City a high statistical poverty rate. Devine, *supra* note 14, at 25. For San Jose, only 6.3 percent of families have an income below the poverty level. U.S. Dept. of Commerce, Bureau of the Census, *County and City Data Book* 675 (1983).

[16] Devine, *supra* note 14 at 21-32. For a broad range of consumer items per capita expenditures in Santa Monica and Berkeley significantly exceeded the statewide averages. For example, statewide expenditures on "radio, TV & music stores" were $132 per capita in 1982; in Santa Monica and Berkeley they were $345 and $401, respectively. For "eating & drinking places," statewide per capita expenditures were $818; in Santa Monica they were $1,582 and in Berkeley they were $957. *Id.* at 28. At the same time, the study found that the private sector had "abandoned" the new construction rental market in Berkeley and Santa Monica. Devine, *supra* note 14, at 64.

[17] Devine, *supra* note 14, at 32 (citing The Wall Street Journal (July 8, 1985)).

Jose is almost 20 percent higher than the state median and the percentage of families below the poverty level is 38 percent lower.[18]

3. *Most State and Federal Officials Have Rejected Rent Control as Bad Housing Policy.*

Confronted by overwhelming evidence that rent control does not work, most state and federal government officials—with the notable exception of local officials in communities like San Jose that continue to impose rent controls—long ago rejected rent control as fatally flawed housing policy. As noted earlier, both Massachusetts and Florida, after initial flirtations with rent control, sharply limited the power of local governments to enact rent control laws. In the District of Columbia, Senator Eagleton, an early proponent of rent control and chairman of the Senate District of Columbia Committee (which initially approved rent control for the District), subsequently reported that "[t]he sad truth is that rent controls—enacted for the best of motives to protect middle- and low-income tenants—actually work against the very people they were designed to aid." [19]

And in California, just prior to enactment of the San Jose Ordinance in 1979, then-Governor Brown reported that:

> Although the present amount of rent regulation in effect in the California housing market is relatively small, the spectre of future controls is already having an impact. Many builders are shying away from multiple unit construction because of the potential of regulation. . . . Some existing owners of rental units are converting the units into condominiums for sale, partly to avoid the rent regulation problem. Thus, rent controls are not only having a direct impact in

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[18] *County and City Data Book, supra* note 15 at 675.

[19] T. Eagleton, "Why Rent Controls Don't Work," Reader's Digest (Aug. 1977).

> a few California communities, but an indirect effect on statewide construction and operation of rental housing.[20]

More recently, the President's Commission on Housing recommended an end to all rent control, if necessary through federal and state preemptive legislation. The blue-ribbon panel [21]—which consisted of economists, housing activists, bankers, builders, realtors, and others from across the political spectrum—conclusively found "that rent control causes a reduction in the quality of the existing rental stock and discourages investment in new rental property" and is "[t]he most evident interference in the ability of the private market to supply rental housing . . . [in] a substantial percentage of the nation's multi-family housing stock." [22]

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[20] Economic Report of the Governor, 1979, prepared by R. Silberman, Director of Finance, State of California at 75 (March 26, 1979).

[21] The Commission was chaired by William F. McKenna (former Chairman of the Home Loan Bank of San Francisco) and Carla A. Hills (former Secretary of the Department of Housing and Urban Development), and included among its other members former Senator Edward W. Brooke (who served as the ranking minority member on the Senate Committee on Banking, Housing and Urban Affairs), and Preston Martin (former Vice-Chairman of the Board of Governors of the Federal Reserve System).

[22] *The Report of the President's Commission on Housing* 91 (1982). As early as 1976, the Senate Committee on Banking, Housing and Urban Affairs issued a report stating that:

> there is no evidence to show that rent control benefits the poor. Quite to the contrary, it helps a small, privileged group of long-time residents, largely middle class, while driving up rents in uncontrolled units.

"Report on the New York City Loan Program," Committee on Banking, Housing and Urban Affairs, S. Rep. No. 900, 94th Cong., 2nd Sess. (1976).

In 1979, the Department of Housing and Urban Development enacted regulations to prevent local rent controls from disrupting

It is only at the local level that there is any support for rent control, where there is substantial middle class support and the broader implications of this fatally flawed housing policy need not be considered.

B. The Absence of a Rational Basis for the Tenant Hardship Provision Violates the Equal Protection Clause.

The Fourteenth Amendment renders unconstitutional legislative classifications that are not rationally related to a legitimate state interest. *City of Cleburne v. Cleburne Living Center*, 473 U.S. 432, 105 S.Ct. 3249, 3258 (1985). This command is "essentially a direction that all persons similarly situated should be treated alike." *Plyer v. Doe*, 457 U.S. 202, 216 (1982). Because the San Jose tenant hardship provision arbitrarily taxes a limited class of property owners and clearly disserves the stated legislative purpose of ensuring adequate and affordable rental housing for low-income tenants, the provision violates this command.

Although state officials ordinarily are accorded wide latitude in devising social or economic legislation, they "may not rely on a classification whose relationship to an asserted goal is so attenuated as to render the distinction arbitrary or irrational." *Cleburne*, 105 S.Ct. at 3258; *see also Zobel v. Williams*, 457 U.S. 55, 61-63 (1982); *United States Department of Agriculture v. Moreno*, 413 U.S. 528, 535 (1973). Accordingly, this Court has not hesitated to strike down social or economic legislation under the Equal Protection Clause where the record

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federal housing programs. 24 C.F.R. Part 246 (1986); 40 Fed. Reg. 49,318 (Oct. 22, 1975). *See also* 48 Fed. Reg. 16,670 (April 19, 1983) (reporting on the disincentives created by rent control to new and continued rental investment).

indicates that the legislation has no legitimate purpose or is not supported by a rational basis.[23]

If ever economic legislation warranted invalidation under the Equal Protection Clause, this is such a case. While the goal of providing adequate and affordable housing to low-income tenants is an important and legitimate one, San Jose's adoption of the tenant hardship provision cannot under any conceivable circumstances be said to further that goal. Like other rent controls, the restriction of rent levels based on a tenant's ability to pay necessarily will diminish the quality and quantity of rental housing available to low-income tenants.[24] Given the virtually universal condemnation of rent control by economists and other policymakers no reasonably informed legislator could believe otherwise.

More importantly, the tenant hardship provision is certain to exacerbate the already substantial bias against renting to low-income tenants. In a market characterized by a "housing emergency," which even San Jose apparently recognizes as the constitutional predicate to valid

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[23] *See, e.g., Cleburne*, 105 S.Ct. 3249 (invalidating zoning ordinance based on irrational prejudice against mentally retarded); *Hooper v. Bernalillo County Assessor*, 472 U.S. 162 (1985) (invalidating tax preference favoring Vietnam veterans based on residency); *Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869 (1985) (invalidating state tax preference favoring domestic insurers); *Plyer v. Doe*, 457 U.S. 202 (1982) (invalidating Texas statute that withheld funds for education of illegal alien children); *Zobel v. Williams*, 457 U.S. 55 (1982) (invalidating Alaska program to distribute state mineral income to adult residents based on the length of their residency); *United States Dept. of Agriculture v. Moreno*, 413 U.S. 528 (1973) (invalidating provision in Food Stamp Act denying benefits to households composed of unrelated members). In each of these cases, the Court looked beyond the asserted justification for the classification and scrutinized the congruence between legislative ends and means.

[24] *See supra* at pp. 10-15.

rent control,[25] owners have substantial discretion in selecting among competing applicants for available rental units. In choosing among such applicants, owners tend to emphasize relative income and creditworthiness, which clearly biases the selection against low-income tenants.

By affirmatively penalizing owners who rent to low-income tenants, the San Jose tenant hardship provision will transform this already significant handicap for low-income tenants into an impenetrable barrier to access. In any market characterized by low vacancy rates and a substantial number of potential tenants for each vacancy,[26] no rational owner will rent to a tenant whose financial circumstances will further limit the owner's permissible return on the rental property.

As Justice Mosk observed,

> The tragic aspect of the provision is that it will likely prove detrimental to the very interests it seeks to protect. Landlords, who will have a great deal to lose by renting to economically marginal tenants, hereafter will carefully screen potential tenants to assure themselves of remaining entitled to a fair return on their properties.

Pennell v. City of San Jose, 720 P.2d at 1120. It is hard to imagine a more effective means of excluding low-income tenants from available rental housing, particularly in middle-class neighborhoods.

San Jose's adoption of the tenant hardship provision is particularly untenable in light of the proven alternatives available to assist low-income tenants. As early as 1972, direct cash subsidies were shown to be an effective and viable means of improving the ability of low-income tenants to obtain and pay for adequate rental housing.[27] Subsidies provide an income supplement to needy tenants without impairing the operation of the rental housing market or compelling rental property owners to avoid renting to such tenants. By increasing tenant mobility, they also permit tenants to leave inadequately maintained or unreasonably priced properties, thereby encouraging owners to make necessary repairs and to keep rents in line with market levels. San Jose simply ignored these alternatives,[28] preferring to burden a select group of

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[25] *See supra* at p. 8 & n.6.

[26] The competition for rental units in rent-controlled markets invariably is intense. San Diego, for example, reportedly had approximately 20 applicants for each vacant rental unit in 1981. San Diego Union, Nov. 20, 1981. ("Rentals Here: Competition's Fierce").

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[27] In 1972, the Department of Housing and Urban Development successfully implemented two cash subsidy programs, known as the Section 8 Existing Housing Program and the Section 8 Experimental Housing Allowance Program. 24 C.F.R. Part 882 (1986); *see* Report on Experimental Housing Allowance Program, filed with Congress pursuant to the Housing and Community Development Act of 1974, 12 U.S.C. § 1701z-3(c) (1976). More recently, the President's Commission on Housing recommended the adoption of cash subsidy programs in lieu of rent control. *The Report of the President's Commission on Housing*, ch. 2, at 17-27 (1982). Tax credit programs also have been suggested as an alternative to rent control. *See, e.g.*, Devine, *supra* note 14, at 75-77 (describing tax credit alternative to rent control).

[28] San Jose's enactment of the tenant hardship provision in the face of overwhelming evidence that the provision will harm rather than help low-income tenants can only be explained as a failure of the political process. By imposing the heavy financial burden of subsidizing low-income tenants on a small and electorally powerless minority—and by providing substantial short-term subsidies to current middle class tenants through other provisions of the San Jose Ordinance (*see supra* pp. 13-15)—the Ordinance effectively mutes the political opposition that otherwise would lead to the rejection of this clearly flawed housing policy. *See City of Cleburne v. Cleburne Living Center*, 105 S.Ct. at 4254. (The Equal Protection Clause permits the states wide latitude in devising social and economic legislation only because "the Constitution presumes that even improvident decisions will eventually be rectified by the democratic processes.")

By burdening only a limited class of property owners with the cost of subsidizing low-income renters, San Jose has placed those

property owners with the full cost of subsidizing low-income tenants.

Finally, the tenant hardship provision cannot draw any support from this Court's "war-time" decisions upholding the use of rent controls in emergency circumstances.[29] Unlike the San Jose tenant hardship provision, the rent controls upheld in these cases were based on explicit and incontestable evidence of a war-generated housing emergency; they were temporary in duration; and their purpose was limited to precluding excessive rents. By contrast, the San Jose tenant hardship provision does not respond to a national—or even a documented local—housing crisis; for all intents and purposes it is a permanent rather than temporary measure; and its purpose is the subsidization of low-income tenants rather than the prevention of excessive rents under extraordinary conditions preventing the proper operation of the housing market.

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owners in "a perpetually losing situation politically." J. Ely, *Democracy and Distrust* 85-86 (1980) (ascribing invalidation of discriminatory tax in *McCulloch v. Maryland* to similar failure of political process). *Cf.* The Federalist, No. 57, at 385 (B. Wright ed. 1961) (the House of Representatives is restrained from "oppressive measures" by the requirement "that they can make no law which will not have its full operation on themselves and their friends, as well as on the great mass of society"); *United States v. Classic*, 313 U.S. 299, 315 (1941) (invalidating state law restricting participation in primary because it deprived affected persons of a meaningful opportunity to vote).

[29] The Court has directly addressed the constitutionality of rent control in only four cases, the most recent of which was decided in 1948. *Block v. Hirsh*, 256 U.S. 135 (1921); *Brown Holding Co. v. Feldman*, 256 U.S. 170 (1921); *Bowles v. Willingham*, 321 U.S. 503 (1944); *Woods v. Cloyd W. Miller Co.*, 333 U.S. 138 (1948). All involved "temporary" rent controls enacted during the First and Second World Wars to counter widespread rent profiteering. While upholding these controls the Court carefully anchored its approval on the express circumstances of a war-generated housing emergency and the temporary nature of the rent control. *See, e.g., Block v. Hirsh*, 256 U.S. at 156.

II. THE SAN JOSE ORDINANCE ALSO VIOLATES THE RIGHT OF PROPERTY OWNERS TO DUE PROCESS BY TAKING PRIVATE PROPERTY FOR PUBLIC USE WITHOUT JUST COMPENSATION.

The Fifth Amendment declares in unequivocal terms that "private property [shall not] be taken for public use, without just compensation." U.S. CONST. amend. V. To the extent the San Jose Ordinance requires owners of rental property to bear a uniquely public burden by subsidizing low-income tenants[30] and, alternatively, deprives them of the right to use or dispose of their rental property as they see fit, the Ordinance works a taking without just compensation.

A. By Imposing A Uniquely Public Burden On Private Parties, The Tenant Hardship Provision Constitutes a Taking Without Just Compensation.

The "Just Compensation Clause" was designed "to bar the government from forcing some individuals to bear burdens which, in all fairness, should be borne by the public as a whole." *San Diego Gas & Elec. Co. v. San Diego*, 450 U.S. 621, 656 (1981); *Armstrong v. United States*, 364 U.S. 40, 49 (1960). This limitation on governmental action has been made applicable to the States through the Fourteenth Amendment. *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 160 (1980).

San Jose's tenant hardship provision violates the "Just Compensation Clause" by imposing on a limited class of property owners the uniquely public burden of subsidizing the income of poor tenants. *Pennell v. City of San Jose*, 721 P.2d at 1119 (Mosk, J., dissenting). San Jose suggests that because the tenant hardship provision was adopted pursuant to the City's police power there cannot be a taking, no matter how arbitrary or excessive the

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[30] Amicus NMHC defers to Appellants' brief for a more detailed analysis of this claim.

provision.[31] This clearly is wrong as a matter of federal constitutional law.

As this Court long ago observed in *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 416 (1922), "while property may be regulated to a certain extent, if regulation goes too far, it will be recognized as a taking." Although "[g]overnment hardly could go on if to some extent values incident to property could not be diminished without paying for every change in the general law," *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 124-25 (1978), "[t]hat is not to say, however, that governmental action in the form of a regulation cannot be so onerous as to constitute a taking which constitutionally requires compensation." *Goldblatt v. Town of Hemp-*

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[31] San Jose's Motion to Dismiss Petition for Certiorari at 7 (filed Dec. 1986). It has been suggested that this Court's takings cases divide into two distinct lines of authority: (a) so-called "physical occupation cases," for which a *per se* taking rule is applied, and (b) "regulatory takings cases," in which the Court has displayed greater caution in finding a taking for fear that to do so would chill regulatory efforts. *Hall v. City of Santa Barbara*, 797 F.2d 1493, 1497 (9th Cir. 1986).

To the extent this distinction is meaningful, *see San Diego Gas & Electric Co.*, 450 U.S. at 651-53 (Brennan, J., dissenting), the tenant hardship provision clearly is a physical occupation case rather than a regulatory takings case. This Court's regulatory takings cases invariably have involved claims that regulatory action has incidentally diminished the value or usefulness of private property without physically invading that property. *See, e.g., Penn Central Transp. Co. v. New York City*, 438 U.S. 104 (1978) (declining to find a taking in New York City's restriction of building heights in the vicinity of Grand Central Station). Thus, a local housing ordinance that imposes additional costs on owners incidental to the exercise of the City's police powers—for example, by requiring a minimum level of maintenance in rental units—could be categorized as a regulatory taking case. By contrast, the tenant hardship provision directly rather than incidentally takes income from affected property owners. Because the taking is direct, there is no need to struggle with the intricacies of "regulatory takings" law.

stead, 396 U.S. 590, 594 (1962); *San Diego Gas & Electric Co.*, 450 U.S. at 647-50 (Brennan, J., dissenting).

While the determination whether a particular regulatory impact constitutes a taking often poses difficult questions, no such questions arise on the facts of this case. As Justice Mosk succinctly stated:

> Simply on the basis of the hardship status of his tenant, one landlord will receive a significantly lower rent than another landlord in *identical* circumstances if the latter merely had the good fortune of renting to a nonhardship tenant. That disparity is untenable when it means that the former landlord is deprived of the reasonable return on his property to which he would otherwise be entitled. Such uneven treatment amounts to a forced subsidy imposed on the landlord in violation of the due process clause . . . which prohibit[s] the taking of property without just compensation.

Pennell v. City of San Jose, 721 P.2d at 119 (Mosk, J., dissenting) (emphasis in original).

"The economic impact of the [tenant hardship provision and] the extent to which it interferes with investment backed expectations," *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 432 (1982), could not be clearer. By its terms, the tenant hardship provision imposes what amounts to a tax on one class of individuals for the direct benefit of another, thereby compelling owners of rental property to forego income to which they otherwise are lawfully entitled.[32] "When one person is asked to assume more than a fair share of the public burden, the payment of just compensation operates to redistribute that economic cost from the individual to the

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[32] The tenant hardship provision complicates the effort even to calculate the probable return on investment in rental property. Owners cannot know in advance whether they will have tenants whose tenancy will subject them to the tenant hardship rent restriction.

public at large." *San Diego Gas & Elec. Co.*, 450 U.S. at 656.[33]

B. San Jose's Impairment of Repossessory Rights Also Is a Taking.

Under well settled precedent there can be little question that, as a "physical taking," San Jose's restriction of the right of rental property owners to exclude others from their property is an uncompensated taking.[34] Although in most cases the Court is required to engage in an "essentially ad hoc, factual inquir[y]" to determine whether a taking has occurred, when confronted with the physical occupation of real property, "this Court has invariably found a taking." *Loretto*, 458 U.S. at 426; *Kaiser Aetna v. United States*, 444 U.S. 164 (1979).[35]

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[33] Were the Court to find that subsidizing a tenant's income is not a public burden, the tenant hardship provision would have to be stricken pursuant to the "public use" condition on the exercise of governmental authority imposed by the Fifth and Fourteenth Amendments. *See Hawaii Housing Authority v. Midkiff*, 467 U.S. 229, 239 (1984). Unlike the land reform legislation upheld in *Hawaii Housing*, which had been adopted to remove "artificial deterrents to the normal functioning of the State's residential land market," the tenant hardship provision serves the very different function of redistributing wealth among private parties. Had Hawaii required landowners not only to sell their land to interested buyers but to sell below the established market price to poor buyers —as in this case—it is doubtful that the land reform legislation would have been sustained.

[34] As in an increasing number of local rent control laws, the San Jose Ordinance provides that owners of rental property cannot avoid rent control by "seeking to recover possession" of their property from a tenant. Section 5706.1 provides in relevant part:

> Possession of a rental unit shall not be recovered by a landlord from a tenant who is not otherwise in default as to the terms of occupancy of said unit, if . . . (b) the dominant motive of the landlord in seeking to recover possession of such rental unit is to evade the purposes of this Chapter.

The "no-eviction" provision of the San Jose Ordinance impairs the right of rental property owners to withdraw from the rental market in response to the tenant hardship provision. As such, it provides an alternative basis for invalidating the San Jose Ordinance.

A "physical taking" occurs when the government intrudes upon private property, either directly or by authorizing another to do so. "In such a case, 'the character of the governmental action' not only is an important factor in resolving whether the action works a taking but also is determinative." *Loretto*, 458 U.S. at 426 (citation omitted). Because such action so clearly and directly intrudes on identifiable property interests, a taking will be found "to the extent of the occupation, without regard to whether the action achieves an important public benefit or has only minimal impact on the owner." *Id.* at 434-35. Such action does not simply take a " 'strand' from the 'bundle' of property rights: it chops through the bundle, taking a slice of every strand." *Id.*; *see Andrus v. Allard*, 444 U.S. 51, 65-66 (1979).

If an owner cannot repossess rental property—the consequence of the "no eviction" provision—the property cannot be withdrawn from the rental market. This radical restriction constitutes a "physical" taking.[36] *See Fresh*

Pond Shopping Center v. Callahan, 464 U.S. 875 (1983) (Rehnquist, J., dissenting from dismissal on other grounds) (finding rent control ordinance that restricted owner's power to evict a taking). *Accord Hall v. City of Santa Barbara*, 797 F.2d 1493 (9th Cir. 1986) (invalidating local ordinance that transferred possessory interest from owner to tenant without just compensation).

Property rights in a thing are defined by the right "to possess, use and dispose of it." *United States v. General Motors*, 323 U.S. 373, 378 (1945). The Court has repeatedly recognized that "the 'right to exclude,' so universally held to be a fundamental element of the property right, falls within the category of interests that the Government cannot take without compensation." *Kaiser Aetna*, 444 U.S. at 179-80 (citation omitted). It also is well established that a "physical" taking does not depend on the actual physical occupation by the government of property. The fact that the physical occupation is by a tenant rather than the State itself, or that the tenant's occupation will not be permanent, is irrelevant. *Loretto*, 458 U.S. at 433 n.9.

In effect, San Jose has barred rental property owners from *any* other use of their property, including vacating and demolishing the property, unless and until current tenants decide to leave.[37] Further, this prohibition is explicitly directed at proscribing repossession where the owner's purpose is to avoid the effect of rent control. As Justice Rehnquist has observed, "this deprives [the owner] of the use of [the] property in a manner closely analogous to a permanent physical invasion, like that involved in *Loretto v. Teleprompter Manhattan CATV Corp.*" *Fresh Pond Shopping Center v. Callahan,* 464 U.S. at 875.[38]

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[35] As Professor Michelman has observed, "[t]he modern significance of physical occupation is that courts . . . *never* deny compensation for a physical takeover." F. Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of 'Just Compensation' Law*, 80 Harv. L. Rev. 1165, 1184 (1967), quoted with approval in *Loretto*, 458 U.S. at 427 n.5.

[36] This essentially is a question of first impression. This Court's sanction of war-time rent control in *Block v. Hirsh*, 256 U.S. 135 (1921), is distinguishable on its facts. *Block* involved a rent control statute enacted by Congress to regulate rents in the District of Columbia during the first World War. Like the San Jose Ordinance, the statute in *Block* regulated both rents and eviction from rental units. However, unlike the San Jose Ordinance, the statute in *Block* was enacted to deal with a wartime emergency. As the Court observed in upholding the statute, "[a] limit in time, to tide over a passing trouble, may well justify a law that could not be upheld as a permanent change." *Id.* at 157. While war does not stay the operation of the Constitution, it influences greatly its interpretation. *See, e.g., Korematsu v. United States*, 323 U.S. 214, 219-20 (1944). Such cases cannot properly be considered as precedent in more settled times.

[37] By its terms, the Ordinance proscribes, subject to civil penalties, the repossession of rental property from a tenant "if the dominant motive . . . in seeking to recover possession . . . is to evade the purposes of this Chapter." The stated purpose of the "Chapter" is to control rents. Nowhere does the Ordinance recognize that an owner's right to put his property to other uses is a sufficient basis for repossessing the property. The sole circum-

In sum, the loss by owners of their reversionary interest in rental property—and thereby of the right to exit the rental housing market in response to the tenant hardship provision—is *per se* a taking, for which just compensation must be provided.[39]

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stance in which an owner's right to seek a certificate of eviction is preserved is where a tenant is in default. San Jose Ordinance § 5706.1(b). This limited repossessory right does not mitigate the taking. *Hall v. City of Santa Barbara,* 797 F.2d 1493, 1500 (9th Cir. 1986).

[38] *See Hall v. City of Santa Barbara,* 797 F.2d 1493 (9th Cir. 1986) (invalidating rent control ordinance that transferred possessory interest from owner to tenant without just compensation). San Jose's authorization of a "fair and reasonable return on the value of [rental] property" in no way minimizes the taking. "Whether compensation is adequate is an inquiry separate from whether there has been a taking." *Id.* at 1500; *see Loretto,* 458 U.S. at 435-36 (finding a taking even though the owner had been compensated). Thus, even if San Jose could ensure that owners will be fairly compensated—which is a dubious proposition to the extent rents are held below market levels—fair rent levels have no bearing on the City's interference with an owner's reversionary interest in the property.

[39] The "no-eviction" provision also violates established constitutional limitations on the power of the state to regulate prices. One who is legally compelled to sell a product at a regulated price must either be permitted to exit from the market or guaranteed a fair return on investment. *See, Munn v. Illinois,* 94 U.S. 113, 126 (1877) (upholding state regulation on the theory that regulated party not legally required to remain in business). Because rent control by definition does not provide a fair return on investment,

CONCLUSION

For the foregoing reasons, the judgment of the California Supreme Court should be reversed.

Respectfully submitted,

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rental property owners must be permitted free exit from the market.

A fair return on investment requires that "the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks." *FPC v. Hope Natural Gas,* 320 U.S. 591, 603 (1944). To the extent that rent control reduces rents below market levels—which measure the return due this investment in relation to the corresponding risks and returns of other investments—owners are deprived of a fair return on investment. *See Almota Farmers Elevator & Warehouse Co. v. United States,* 409 U.S. 470, 473-74 (1973) (defining "just compensation" by reference to the "market value" of property, and holding that an "owner is entitled to the fair market value of his property" which "is normally to be ascertained from 'what a willing buyer would pay in cash to a willing seller' ").

San Jose cannot have it both ways; either it must permit owners to receive fair returns on investment, as determined in the marketplace, or it must permit regulated owners to leave the rental housing market. The choice is particularly compelled by the tenant hardship provision, whose specific effect is to preclude owners from passing on to tenants otherwise reasonable costs.

AMICUS CURIAE

BRIEF

86-753

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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

RICHARD PENNELL and
TRI-COUNTY APARTMENT
HOUSE OWNERS ASSOCIATION,
Appellants,
vs.

CITY OF SAN JOSE and CITY
COUNCIL OF THE CITY OF SAN JOSE,
Appellees.

ON APPEAL FROM THE SUPREME COURT
OF THE STATE OF CALIFORNIA

BRIEF AMICUS CURIAE OF THE CALIFORNIA ASSOCIATION OF REALTORS ® IN SUPPORT OF APPELLANTS

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ON APPEAL FROM THE SUPREME COURT
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INTEREST OF AMICUS CURIAE

Pursuant to supreme court rule 36, the CALIFORNIA ASSOCIATION OF REALTORS® respectfully submits this amicus curiae brief in support of Appellants, Richard

Pennell and Tri-County Apartment House Owners Association.

Amicus curiae CALIFORNIA ASSOCIATION OF REALTORS® (C.A.R.) is a voluntary trade association whose members consist of Boards of Realtors in California and those persons licensed by the State of California as real estate brokers and salespersons who are members of local boards. C.A.R. is the largest state trade association in the United States and has over 180 affiliated Boards of Realtors and over 115,000 members. C.A.R.'s members are in the business of buying, selling, and managing residential rental units on a daily basis.

The mission of C.A.R. is to serve in developing and promoting programs and services that will enhance the members' freedom and ability to conduct their

individual businesses successfully with integrity and competency. Moreover, C.A.R. serves to promote, through collective action, the preservation of real property rights.

C.A.R. is of the belief that the continuing demand for rental housing can best be met by private investors willing to make long-term capital risks. We support a mutually beneficial owner-rental occupant relationship which will encourage a continuing supply of adequate and affordable housing.

The California rule that requires a landlord to subsidize the welfare of low-income tenants by preventing rental increases because of an individual tenant's economic hardship has far-reaching significance to the real estate industry engaged in the purchase, sale, rental and management of residential rental property. The California rule allows municipalities to impose regulations that deprive a private property landowner of a just and reasonable return on his property in violation of established law.

Counsel for C.A.R. are familiar with the question involved and the scope of their presentation and believe that further argument on the issues discussed by this amicus brief will be helpful to this Court.

SUMMARY OF ARGUMENT

This Court is presented with a question which has far-reaching effects on the real estate industry: whether a private property owner can be mandated by a municipality to subsidize low-income tenants, thereby not permitting the landlord a just and reasonable return on his property.

The decision of this Court ranges far beyond the city limits of San Jose. According to the 1980 Census, U.S. Bureau of Census, U.S. Census of Housing, U.S. Dept. of Commerce, and Current Housing Reports, series H-150-83, Annual Housing Survey, Part A there are 29,914,000 renter-occupied housing units, approximately 35% of all housing units in the United States.

There are approximately 70 jurisdictions in California with an ordinance in effect that regulates the economic relationships between a landlord and tenant. Rent Control at the Local Level: An Update, CALIFORNIA ASSOCIATION OF REALTORS® p. 25 (1986).

A considerable number of these ordinances contain language that grants a hearing officer or other decision-making body the authority to consider "all relevant factors" when evaluating a request for rental increase.

The California Supreme Court in Pennell v. San Jose, 42 Cal.3d 365 (1986), has stated that the financial condition of a tenant is a relevant factor to be considered in granting rental increases. Basically, that court stated that no rent increase will be

granted if the hearing officer determines that the proposed increase constitutes an unreasonably severe financial or economic hardship on the tenant despite the fact an increase is otherwise warranted.

If the California rule is left intact, other jurisdictions will interpret it as a sign that they may in fact force individual landlords to subsidize low-income tenants to their own financial detriment. The validity of the San Jose ordinance fails because it compels private individuals to bear the burdens of society. and it is not reasonably calculated to achieve its stated goals.

ARGUMENT

RENT REGULATIONS THAT COMPEL INDIVIDUAL PROPERTY OWNERS TO SUBSIDIZE LOW-INCOME TENANTS BY PROHIBITING RENTAL INCREASES BASED ON TENANT FINANCIAL HARDSHIP VIOLATE THE POLICY BEHIND THE FIFTH AND FOURTEENTH AMENDMENTS.

In the words of Justice Mosk dissenting in the Pennell case

> "[S]atisfying the housing needs of persons in lower economic strata is necessary, but the issue is whether that obligation can be thrust upon private property owners rather than remaining the responsibility of society as a whole through tax supported government agencies." Pennell at 733.

The Supreme Court of California has chosen to make the private property owner a subsidizer of public housing costs in violation of the U.S. Constitution. Based on the hardship status of a tenant, one landlord will receive a significantly lower rent than another landlord in identical circumstances, save the fact the latter did not rent to a hardship tenant. This disparity which denies the former landlord a reasonable return on his property, amounts to a forced subsidy in violation of the Just Compensation Clause of the Fifth and Fourteenth Amendments.

A. A Local Rent Regulation Cannot Reasonably Alleviate Financial Hardship Of Tenants While At The Same Time Provide A Fair And Reasonable Return On Value Of The Property.

This Court has held that overly harsh regulations can constitute a taking under the Just Compensation Clause of the Fifth and Fourteenth Amendments of the Constitution. (Pennsylvania Coal Co. v.

Mahon, 260 U.S. 393 (1922); Penn Central Transportation Co. v. New York, 438 U.S. 104 (1978); Pruneyard Shopping Center v. Robins, 447 U.S. 74 (1980); San Diego Gas & Electric v. San Diego, 450 U.S. 621 (1981) (Brennan, J., dissenting).)

A regulation will be deemed a taking by this Court if it "does not substantially advance state interests or denies an owner economically viable use of his land." Agins v. Tiburon, 447, U.S. 255, 260 (1980); see also Penn Central at 124.

This Court has also held that the constitutional right of due process is violated when the result of the regulation is not rationally related to the general purpose of that regulation. Nebbia v. New York, 291 U.S. 502 (1934).

Although admittedly the offending ordinance does not appear to totally

deprive appellants of economically viable use of the property, C.A.R. is of the opinion that the ordinance not only does not advance state interests, it hinders them.

This court has an obligation to look beyond the stated goal of an ordinance to determine if the means employed can reasonably achieve the stated goal.

The stated purpose of the particular ordinance in question is inter alia:

> "... the prevention of excessive and unreasonable rent increases, the alleviation of undue hardship upon individual tenants, and the assurance to landlords of a fair and reasonable return on the value of their property." San Jose Municipal Ordinance 19696, Section 5701.2.

The real issue is whether requiring landlords to reduce rents below the level determined as a fair and reasonable rate of return is reasonably calculated to meet the goal of "alleviating undue hardship upon tenants." Emphasis added.

"Undue" is defined in Random House Dictionary of English Language, Unabridged edition (1966) as "unwarranted, excessive." The San Jose ordinance allows the one factor of the financial condition of a tenant to override the other factors which would otherwise justify a rental increase based on the hardship of the landlord. Save for the tenant's financial status these other factors would justify a rental increase which is neither unwarranted nor excessive. In other words, the financial status of a tenant can deny a landlord a fair and reasonable return on the value of the property in violation of a stated goal of the ordinance.

An artificial reduction in rents merely disguises the greater problem of poverty and inadequate low-income housing at the expense of the individual landlord. In fact, the ordinance may create an even more invidious problem, that of discrimination against low-income tenants. It is not difficult to construct a scenario which shows the ordinance to be counterproductive to the stated purpose. Landlords will carefully screen tenants vis-a-vis income to ensure that they will be able to receive a just and reasonable return on their property; as a result many low-income tenants could be denied housing they might otherwise have been offered.

The California Supreme Court now has added a new factor for consideration in both the purchase and renting of residential rental units -- the financial hardship of the individual tenants. Discrimination against a class of persons is an activity the California Supreme Court has stated a landlord cannot engage in when screening tenants.

> "Whether the exclusionary policy rests on the alleged undesirable propensities of those of a particular race, nationality, occupation, political affiliation, or age, in this context the Unruh Act protects individuals from such arbitrary discrimination." Marina Point, Ltd. v. Wolfson, 30 Cal.3d 721-726 (1982) emphasis added.

Presumably, that Court would prohibit an arbitrary policy against low-income tenants as a class of persons. Is the same Court now stating that a landlord has a reasonable basis for establishing an exclusionary policy against that same class of people? It would appear so.

The very problem the ordinance purports to alleviate is in reality exacerbated by forcing the landlord to evaluate financial hardship when screening potential tenants.

B. SUBSIDIZING THE LOWER ECONOMIC STRATA IS A PUBLIC BURDEN AND THE IMPOSITION OF SUCH A BURDEN ON AN INDIVIDUAL IS A VIOLATION OF CONSTITUTIONAL POLICY.

The underlying policy of the Just Compensation Clause is to ensure that a private property owner is not forced to bear an inordinate share of the burden of financing public programs. As stated in Agins:

> "The determination that governmental action constitutes a taking is, in essence, a determination that the public at large, rather than a single owner, must bear the burden of an exercise of state power in the public interest. Although no precise rule

> determines when property has been taken, (cite omitted) the question necessarily requires a weighing of private and public interests." Agins at 260-61.

C.A.R. is of the opinion that solutions to the housing problems in this country cannot be resolved by requiring owners of private property to subsidize the income of financially strapped tenants. We do not require a grocer to lower its prices for those who cannot pay for the food they want. We do not require a doctor to lower his fee for those who cannot pay for medical services. We do not require that owners of gas stations lower the price of gasoline for those who cannot pay transportation costs. We do not require insurance companies to weigh the financial status of insureds when increasing a premium.

Why then is a landlord required to forego a fair and reasonable return on value of his property?

In each of these situations, the policy decision has been made either to provide direct subsidization from the government or let the market place function freely. A specific policy is in place that individual subsidization is not the norm. Financial assistance for the lower economic strata is a burden to be borne by the public as a whole.

In San Jose, the landlord who rents to a low-income tenant is forced to forego a just and reasonable return on the value of his property only because the tenant cannot afford the increase.

There is nothing in the present law that supports the position that an individual landlord is required to cure the financial difficulties of a tenant. On the contrary, there is a line of California cases that holds quite the opposite, stating that an individual is not required to bear the expense of a state function. See: Department of Mental Hygiene v. Kirchner, 60 Cal.2d 716 (1964), Department of Mental Hygiene v. Hawley, 59 Cal.2d 247 (1963); See also the New Jersey case Property Owners Association, etc. v. Township of No. Bergen, 74 N.J. 327, 378 A.2d 25 (1977) (Landlord subsidy of senior citizens invalid as confiscatory). The California Supreme Court chose not to follow this line of cases. We ask that this court reverse that decision.

The issue of housing for the American populace, not to mention the low-income segment of our society, is a

nationwide problem as evidenced by the Congressional declarations of purpose for both the Department of Housing and Urban Development Act and the United States Housing Act:

> "The Congress hereby declares that the general welfare and security of the Nation and the health and living standards of our people require, as a matter of national purpose, sound development of the Nation's communities and metropolitan areas in which the vast majority of its people live and work. 42 U.S.C. Section 3531.

> "It is hereby declared to be the policy of the United States to promote the general welfare of the Nation by employing its funds and credit, as provided in this Act, to assist the several States and their political subdivisions to alleviate present and recurring unemployment and to remedy the unsafe and insanitary housing conditions and the acute shortage of decent, safe, and sanitary dwellings for families of low income, in urban, rural nonfarm, and Indian areas, that are injurious to the health, safety, and morals of the citizens of the Nation. 42 U.S.C. Section 1401 et seq.

See also: Toward A National Housing Policy (1987), (A Joint Document of the National Association of Home Builders, the National Association of Realtors, and the Mortgage Bankers Association of America); Johnson, Resolving the Housing Crisis, Government Policy, Decontrol, and the Public Interest, (1982), Housing -- A Reader, Committee on Banking, Finance and Urban Affairs prepared by the Congressional Research Service Library of Congress (1983).

C.A.R. is certainly not suggesting that this Court is faced with a simple, straightforward task. Learned scholars have debated the issue of what constitutes a "taking" and offered a myriad of approaches. This case is now before this Honorable Court because there is no consensus on the solution. (See: Sax,

Joseph L., Takings and the Police Power, 74 Yale L.J. 36 (1964); Sax, Joseph L., Takings, Private Property and Public Rights, 81 Yale L.J. 149 (1971); Stoebuck, William, Police Power, Takings, and Due Process, 37 Wash. and Lee L.R. 1057 (1980); Bauman, The Supreme Court, Inverse Condemnation and the Fifth Amendment: Justice Brennan Confronts The Inevitable In Land Use Controls, 15 Rutgers Law Journal 15 (1983); Blume & Rubinfeld, Compensation for Takings: An Economic Analysis, 72 Calif.L.Rev. 569, (July 1984); Berger & Kanner, Thoughts On The White River Junction Manifesto: A Reply to the Gang of Five's View on Just Compensation for Regulatory Taking of Property, 19 Loy.L.A. L.Rev. 685 (1986); Michelman, F., Property, Utility, and Fairness: Comments On The Ethical

Foundations of "Just Compensation" Law, 80 Harv.L.Rev. 1165 (1967).)

Professor Michelman in his well-reasoned article made the following observation regarding the manifest unfairness in shifting the public burden to individuals. Although Professor Michelman is specifically referring to the effects of urban development programs it equally applies to the facts in this case.

> "The social gains hoped for from some urban redevelopment programs while plausible enough to override any 'public purpose' objection, nevertheless depend on a still controversial conception. Easily identified, relatively small numbers of people are being handed a distinctly disproportionate and frequently excruciating share of the cost of whatever social gain is involved." Michelman p. 1255.

The Constitution demands a more equitable result.

CONCLUSION

Providing affordable housing for low-income tenants is not only a California problem, it is a nationwide problem that requires this Court's attention and direction. If the California law is allowed to stand, it sends a signal to the rest of this country that an individual private property owner can be forced to subsidize low-income tenants.

In the words of Justice Mosk dissenting in Pennell:

> "[T]here is no rational link either in the benefit gained or the burden created which would justify imposing that welfare obligation as a one-on-one subsidy, rather than spreading the imposition fairly through the class of landlords generally or

taxpayers as a whole." Pennell at 733.

This Court is respectfully asked to reverse the California Supreme Court's holding.

DATED: May 15, 1987

Respectfully submitted,
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AMICUS CURIAE

BRIEF

No. 86-753 (A)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

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Appellants,

v.

CITY OF SAN JOSE and CITY COUNCIL OF THE CITY OF SAN JOSE,

Appellees.

On Appeal from the Supreme Court of the State of California

BRIEF OF AMICUS CURIAE NATIONAL ASSOCIATION OF REALTORS® IN SUPPORT OF APPELLANTS

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BRIEF OF AMICUS CURIAE NATIONAL ASSOCIATION OF REALTORS® IN SUPPORT OF APPELLANTS

All parties of record in this case have consented pursuant to Supreme Court Rule 36.2 to the filing of this amicus curiae brief in support of Appellants. These consents are filed herewith.

IDENTITY OF AMICUS

The NATIONAL ASSOCIATION OF REALTORS® (hereinafter "NAR") is a not-for-profit professional association comprised of over 700,000 persons engaged in all phases of the real estate business.

NAR was created in 1908 to promote and encourage the highest and best use of the land, to protect and promote private ownership of real property and to advance professional competence in the rendition of real estate services.

NAR includes among its members real estate brokers, managers, appraisers, counselors and a variety of other participants in the residential, commercial, industrial, farm and investment real estate markets. Through its many programs and the programs of its affiliated Institutes, Societies and Councils, NAR has been involved in and committed to the solution of every significant problem encountered by real property owners for over three quarters of this century. Through its long and undeviating commitment to the protection of the rights and interests of property owners, NAR has earned the right to speak not only for real estate professionals but for all American property owners.

Of the problems which have concerned NAR, few have been more fundamental or of greater importance than preservation of the private property rights established by the United States Constitution. This commitment to safeguarding private property rights is the cornerstone of NAR, for without such rights there would be no ownership, development, transfer, or enjoyment of real estate.

INTEREST OF AMICUS

The interest of NAR in this case arises from its longstanding concern for governmental regulation of rents. Rent controls were first imposed during wartime as temporary measures to insulate tenants from exposure to unusually high rents arising out of national crisis. In contrast, rent control ordinances of today are generally imposed neither temporarily nor in response to national emergency.

NAR's concern about rent control is derived from its membership, the nation's real estate professionals, as well as the owners, prospective owners and other users of real estate whom those professionals serve.

NAR welcomes this opportunity to offer its perspective on the constitutionality of municipal rent control ordinances, which erode the nation's rental housing stock in the name of the public well-being. It is painfully evident that such attempts to provide adequate, affordable housing for Americans by government intrusion into private commercial relationships between landlords and tenants have hopelessly failed.

NAR does not propose to duplicate the arguments ably presented in Appellant's Brief, but endorses and urges this Court to adopt that reasoning. Further, to avoid unnecessary repetition, NAR adopts the statement of the case set forth in Appellant's Brief. NAR's purpose in submitting this brief *amicus curiae* is to emphasize to this Court the inevitable and catastrophic results of using the police power to impose rent control. Although the specific provisions of the ordinance at issue here may be unique, this case nevertheless provides this Court an opportunity to consider the manner in which rent control ordinances inherently fail to meet their stated objectives and exacerbate, rather than alleviate, a scarcity of reasonably priced, sufficiently maintained rental housing available to a community's residents.

INTRODUCTION

NAR seeks reversal of the decision of the California Supreme Court and invalidation of San Jose Rental Dispute Mediation and Arbitration Ordinance 19696[1] ("Ordinance"). Three considerations compel this result.

First, NAR submits that rent control is a form of economic regulation which utterly fails to satisfy even the wide scope of the due process requirements of the Fourteenth Amendment, as described by this Court in *Nebbia v. New York*, 291 U.S. 502, 537 (1934):

> So far as the requirement of due process is concerned, and in the absence of other constitutional restriction, a state is free to adopt whatever economic policy may reasonably be deemed to promote public welfare, and to enforce that policy by legislation adapted to its purpose.

Years of experience with rent control regulation and scholarly analysis of that experience uniformly indicates that rent control is a highly effective method of reducing or eliminating a community's supply of adequate, well-maintained rental housing, rather than retaining or increasing that supply. Thus, however the legislative objectives may be articulated, the real consequences of rent control are antithetical to the intent to provide for the general welfare by enhancing the availability of suitable rental housing. The appropriate standard of review to be applied in rent control cases must therefore be one which does not permit passive judicial deference to regulatory schemes which are demonstrably inconsistent with stated legislative objectives. NAR believes this Court should apply the lessons of experience to this ordinance, and should require a standard which incorporates those lessons to be judicially applied in rent control ordinance challenges generally.

Second, although this Court has established that "the Constitution does not forbid the imposition, in appropriate circumstances, of maximum prices upon commercial and other activities," *Permian Basin Area Rate Cases*, 390 U.S. 747, 768 (1968), the power to limit prices is not boundless:

> Regulation may, consistently with the Constitution, limit stringently the return recovered on investment, for investor's interests provide only one of the variables in the constitutional calculus of reasonableness.

The Constitution thus permits price regulation to "limit stringently" but not *eliminate* investment return, and such regulation must in any event be "just and reasonable." 390 U.S. at 769. NAR asserts that because the "just and reasonable" limitation on price regulation is intended to protect the owner's ability to recover a fair return on his investment, a constitutionally just price limitation must provide a return which duly accounts for the property owners' investment and costs and a fair return thereon. If after establishing a price below "market" but nevertheless deemed reasonable in light of the investor's costs, that price is reduced further based on the relative affluence of the purchaser, the owner will never receive the fair return which the Constitution guarantees.

---

[1] See Jurisdictional Statement of Appellants, pp. A-34-50.

Finally, the Fifth Amendment prohibits the deprivation of private property unless such deprivation advances a legitimate public purpose, and further requires that the burden of advancing that public purpose not fall excessively and unfairly upon private parties rather than the public. Sections 5703.28(c)(7) and 5703.29 of the Ordinance (the "tenant hardship provisions"), however, confer only private, and not public benefits, except perhaps the "public benefit" of protecting the municipal treasury. And even if the subsidization of particular individual tenants is somehow deemed to serve a public interest, the expense associated with doing so is a public burden which in fairness and justice should be borne by the public, *Penn Central Transportation Co. v. New York*, 438 U.S. 104, 123 (1978).

ARGUMENT

I.

RENT CONTROL ORDINANCES INHERENTLY FAIL TO SATISFY THE DUE PROCESS REQUIREMENTS ESTABLISHED BY *NEBBIA v. NEW YORK.*

> Rent control has in certain western countries constituted, maybe, the worst example of poor planning by governments lacking vision.[2]

---

[2] Gunnar Myrdal, quoted in S. Rydenfelt, *The Rise and Fall of Swedish Rent Control*, in *Rent Control—A Popular Paradox* 182 (1975).

Rent control programs are traditionally adopted in response to a legislative body's perception that rents are unacceptably high because of undesirable economic market conditions. In adopting the Ordinance, the San Jose City Council declared that "there is a growing shortage of and increasing demand for housing in the City of San Jose. This circumstance coupled with increasing inflation, the rising cost of developing new housing and other factors have put substantial upward pressure on residential rents."[3]

Unfortunately, a legislature's adoption of rent control fails to correct such problems because it provides only temporary relief for a limited number of tenants. The symptoms of the problem are briefly alleviated but the malady persists. In the long term, the inevitable consequence of rent control is to accelerate the demise or elimination of reasonably priced, adequately-maintained rental housing.[4] Tenants may be shielded from paying higher rents, but inevitably they pay in the form of inadequate maintenance and deterioration of their rent controlled units. Rent control ordinances have consistently proven themselves to be counterproductive, unfair, sometimes a subsidy for middle-class or even wealthy renters who do not need help, detrimental to the community and ultimately harmful to precisely the low-income tenants they are designed to protect.

Scholarly studies, commentators and empirical data from rent-controlled communities have uniformly reflected the pernicious effects of rent control on a community's rental housing and the well-being of the community and its citizens. The Bureaus of Competition, Consumer Protection and Economics of the Federal Trade Commission, for example, when asked to comment on the proposed District of Columbia Rental Housing Act of 1985, stated their view bluntly:

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[3] Section 5701.2 of the Ordinance, Jurisdictional Statement of Appellants, p. A-34.

[4] W. Hirsch, *From "Food for Thought" To Empirical Evidence About Consequences of Landlord—Tenant Laws*, 69 Cornell L.Rev. 604, 611 (1984).

> Enactment of any rent control bill would be harmful to the D.C. economy and would not help the poor and the elderly get decent, affordable rental housing. The long term effect of rent control is to destroy the stock of rental units through deterioration, abandonment and lack of replenishment.[5]

The Bureaus noted specifically that rent control tends to divert investment in rental housing to nearby non-controlled areas, to skew housing investment toward owner (condominium and cooperative) housing, and to result in deterioration and abandonment of a significant part of the rental housing stock. *Id.* at 2-4.

These views have been echoed by others analyzing rent control ordinances across the nation:

> –(W)e conclude that rent control is likely to have detrimental effects on the supply and maintenance of rental housing, particularly for low income tenants.[6]
>
> –(T)he evidence from New York City strongly suggests that rent control exacerbates rather than solves a housing shortage.[7]

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[5] Comments of the Bureaus of Competition, Consumer Protection and Economics of the Federal Trade Commission on Council Bill 6-88, The Rental Housing Act of 1985, 2 (1985).

[6] J. Brenner and H. Franklin, *Rent Control in North America and Four European Countries* 67 (1977).

[7] E. Olsen, *Questions and Some Answers About Rent Control: An Empirical Analysis of New York's Experience*, in *Rent Control—A Popular Paradox* 148 (1975).

> –(R)ent control . . . tends to engender *in the long run* overall deterioration in the housing market . . . . (T)he adoption of rent controls in an area, such as Los Angeles, may have several perverse economic effects that in the long run will exacerbate the decline in general rental and non-rental housing markets . . . .[8]
>
> –The Committee feels it is necessary to emphasize its principal conclusion that a traditional Rent Control program should not be instituted in the City of Chicago. Moreover, this Committee is convinced that formalized rent controls will produce a number of very serious deleterious effects . . . .[9]

This condemnation of rent control is not limited to such ordinances in America. Rent control programs have been judged equally damaging in France: "Possibly the French example may prove of some interest and use to our friends across the sea. It goes to show that rent control is self-perpetuating and culminates in both the physical ruin of housing and legal dispossession of the owners."[10] Rent control has produced essentially identical results in Sweden,[11] Austria[12] and Canada.[13]

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[8] R. Edelstein, *An Evaluation of Rent Control as a Housing Policy Instrument* in *An Analysis of the Los Angeles Rental Housing Market* 102 (1979).

[9] Chicago Rent Control Committee, *Report to Mayor Michael A. Bilandic* 51 (1977).

[10] B. De Jouvenel, *No Vacancies*, in *Rent Control—A Popular Paradox* 112 (1975).

[11] S. Rydenfelt, *supra* note 2.

[12] F. Hayek, *The Repercussions of Rent Restrictions* in *Rent Control—A Popular Paradox* 65 (1975).

[13] S. Hamilton and D. Baxter, *Landlords and Tenants in Danger—Rent Control in Canada* (1975).

This uniform and ringing denunciation of the impact of rent control ordinances makes it clear that the legislative objectives commonly articulated as the basis of such ordinances are not merely unserved but in fact defeated by the very legislative programs adopted to further those objectives. Where political and economic forces have produced an unsatisfactory or deficient rental housing market, NAR would concur with a legislative body's adoption of economic policies and programs intended to stimulate and enhance the availability and supply of properly-maintained, affordable rental housing.[14] Rent control, however, is "demonstrably irrelevant," *Nebbia*, 291 U.S. at 539, and indeed antagonistic to such policies and objectives. Although quite permissive, the *Nebbia* formulation of the requirements of due process does not grant unrestricted freedom in the area of economic legislation, but permits pursuit of an articulated economic policy only "by legislation adapted to its purpose." *Id.* 291 U.S. at 537. NAR urges this Court to acknowledge that rent control has been repeatedly shown by undisputed empirical evidence to be incapable of achieving its legislative objectives, and to apply the *Nebbia* due process test to preclude municipalities from pursuing such ineffective and misdirected attempts to assist a community's tenants.

Accordingly, in this case involving the San Jose rent control ordinance, as well as in other challenges to rent control legislation, this Court should require lower courts to recognize these facts regarding the actual impact of such legislation, and require a reliable and specific showing that, in light of those facts, the legislative objectives

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[14] For example, the FTC study, *supra* note 5, at 12, concluded that "if housing assistance is necessary for the poor, it should be provided directly, without the harmful economic distortions caused by rent controls."

will, in fact, be served. If they are not, as in the numerous examples cited herein, courts must not meekly defer to legislative bodies but must invalidate those programs as violative of the Fourteenth Amendment. Anything less leaves *Nebbia* and the Fourteenth Amendment's due process clause void of all substance.

II.

PRICE REGULATION MAY NOT ESTABLISH PRICES TO ACCOMMODATE THE RELATIVE WEALTH OF PURCHASERS OF THE REGULATED GOODS OR SERVICES.

This Court has already recognized that the Constitution permits governments to establish maximum prices in appropriate circumstances. *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968). But in three cases[15] involving prices established by the Federal Power Commission under the Natural Gas Act, 15 U.S.C. §717 *et seq.*, this Court has also declared that the Constitution imposes limits on such price regulation, and, indeed, that the Constitutional limitations are identical to those prescribed by Congress in that Act. *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942). The standard established by the Act, and thus by the Constitution in other contexts, is that the prices established be "just and reasonable." *Permian Basin Area Rate Cases*, 390 U.S. at 770.

Significantly, in each of these cases the Court was reviewing natural gas rate orders prescribed by the Federal

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[15] *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575 (1942).

Power Commission wherein the Commission established a reasonable rate of return to be applied to a "rate base" comprised of the appropriate costs and expenses incurred by natural gas producers in obtaining and distributing natural gas. Thus, in accordance with the requirements of the Act and the Constitution, "just and reasonable" gas prices were calculated on the basis of economic considerations of the *sellers* rather than the buyers. The Court has given no indication that factors other than the seller's costs and investment, and perhaps normal market forces,[16] may be accommodated in establishing just and reasonable rates. In particular, the ability of consumers to pay the established natural gas prices was neither discussed nor considered by the Court or the Commission in establishing just and reasonable rates.

To be sure, *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1944), notes that in allowing investors to realize a return "commensurate with returns on investments in other enterprises having corresponding risks," 320 U.S. at 603, the fixing of just and reasonable rates may involve a balancing of the interests of investors and consumers. But the balancing of consumer interests in this fashion cannot reasonably go so far as to permit consideration of particular consumers' ability to afford to pay the prices so established without utterly disregarding the investors' right to a reasonable return. Rather, those consumer interests may fairly include only those of the sort which inspired Congress to empower the Federal Power Commission to regulate rates, namely, a concern for consumer's exposure to *excessive* and *unjustifiably* high natural gas prices resulting from monopolistic market forces, *Texaco*, 417 U.S. at 397-98, and to provide a "complete, permanent and effective bond of protection from excessive rates and charges." *Permian Basin*, 390 U.S. at 795 (citation omitted).[17] Shielding consumers from high prices that allow excessive windfall profits is far different than limiting prices to what individual consumers may be able to afford. The former is a consumer interest which may be accommodated provided investors realize a fair return; the latter may not be accommodated in any event.

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[16] *Federal Power Commission v. Texaco, Inc.*, 417 U.S. 380, 399 (1974) suggests that some consideration of market prices is permissible.

In sum, a scheme which permits prices to be prescribed based on the relative wealth of particular purchasers is inconsistent with this Court's formulation of the "just and reasonable" standard. Without the tenant hardship provisions, the Ordinance here quite properly takes into account the landlord's costs of maintenance, debt service, capital improvements, rehabilitation and other expenses, and thus provides the landlord an opportunity to earn a return which, as the Constitution requires, is "just and reasonable" to him. Addition of the tenant hardship provisions, however, permits further reduction in the rent based on other factors unrelated to the landlord's costs of acquiring and operating the premises, thus denying him his constitutionally protected reasonable return on his investment.

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[17] Similarly, this Court has acknowledged the appropriateness of consideration of other general consumer interests, such as a pricing structure providing a "useful" incentive to exploration, *Permian Basin*, 390 U.S. at 795, or the fairness of supporting a discrimination-free work environment by disallowance from the rate base of the costs of a utility's discriminatory employment practices. *NAACP v. Federal Power Commission*, 425 U.S. 662 (1976).

III.

THE SAN JOSE ORDINANCE VIOLATES THE FIFTH AMENDMENT.

A. Reduction Of Rents Based On The Tenant Hardship Provisions Takes The Property of the Landlord for the Benefit Of The Tenant.

The Fifth Amendment permits economic regulation, such as establishing maximum rents or other prices, in order to advance legitimate public interests. This Court has previously sustained rent control ordinances adopted to further the desire to protect tenants from excessive rents as a result of undue and unusual landlord market leverage in extraordinary circumstances. *Woods v. Miller Co.*, 333 U.S. 138 (1948), *Bowles v. Willingham*, 321 U.S. 503 (1944), *Block v. Hirsh*, 256 U.S. 135 (1921), *Marcus Brown Holding Co. v. Feldman*, 256 U.S. 170 (1921).

Even assuming that the Ordinance here, exclusive of the tenant hardship provisions, permissibly regulates rents in the public interest, the effect of the tenant hardship provisions is merely to redistribute funds from the landlord to the tenant. Application of Section 5703.28 of the Ordinance, by its very language, establishes a "reasonable" rent increase. Further reduction of the reasonable amount so fixed, for the sole purpose of mitigating a perceived hardship on the tenant, however, is substantively indistinguishable from appropriation of funds of the landlord, in the amount of the hardship reduction, and distribution of those funds to the tenant. Since "one person's property may not be taken for the benefit of another private person without a justifying public purpose, ...," *Thompson v. Consolidated Gas Corp.*, 300 U.S. 55, 80 (1937); *see also Hawaii Housing Authority v. Midkiff*, 467 U.S. 229, 241 (1984), the tenant hardship provisions cannot be sustained unless they advance a cognizable and legitimate public purpose. Moreover, even if such a public purpose exists, the tenant hardship provisions may not impose on property owners a burden which, "in all fairness and justice, should be borne by the public as a whole." *Armstrong v. United States*, 364 U.S. 40, 49 (1960), *Penn Central Transportation Co. v. New York*, 438 U.S. 104, 123 (1978). Because the tenant hardship provisions of the Ordinance cannot be sustained on either basis, they must be declared invalid.

B. The Tenant Hardship Provisions Are Unconstitutional Because They Serve No Legitimate Public Purpose.

The Constitution forbids "even a compensated taking of property when executed for no reason other than to confer a private benefit on a particular private party." *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229, 245. The *only* purpose of the tenant hardship provisions of the Ordinance is to convey a portion of otherwise allowable and reasonable rent increases from landlords to particular tenants. Since no public purpose exists to justify this taking of the funds of landlords, these provisions violate the Fifth Amendment.

Consideration of this Court's decision in *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229 (1984), provides an understanding of the "public use" requirement of the Fifth Amendment and the failure of the Ordinance to satisfy that requirement. In *Midkiff*, the Hawaiian legislature had concluded that concentration of land ownership in a very few hands in the state was injurious to the "public tranquility and welfare," as it unduly disrupted the orderly transfer of land titles at fair and reasonable prices. To eliminate this problem, the Land Reform Act of 1967 was adopted to permit groups of land tenants to acquire title to the properties on which they lived. The Act provided for a process for condemnation of such land and suitable compensation to be paid to the landowners.

Although the result achieved by the legislation was redistribution of land titles among purely private parties, this Court concluded that the public use requirement was not violated because the Act was an attempt "to correct deficiencies in the market determined by the state legislature to be attributable to land oligopoly." 467 U.S. at 243. The legislature's intent to cure defects in the land market was fundamental to this conclusion, and this Court recognized that had the legislature intended to simply benefit the tenants who were permitted to acquire the land on which they lived the Act would not pass Fifth Amendment muster:

> A purely private taking could not withstand the scrutiny of the public use requirement; it would serve no legitimate purpose of government and would thus be void. But no purely private taking is involved in these cases. The Hawaii legislature enacted its Land Reform Act not to benefit a particular class of identifiable individuals but to attack certain perceived evils of concentrated property ownership in Hawaii . . . .

467 U.S. at 245.

It is true, of course, that a "public purpose" need not provide benefits available to or enjoyed by all members of the public, or that the property taken be committed and open for use by the general public. *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1014 (1983). But while individuals may enjoy particular benefits as a collateral result of a governmental action, the purpose served must have a "public character." Thus, in *Monsanto*, even though competing pesticide producers would benefit from the data-consideration and data-disclosure provisions of the

Federal Insecticide, Fungicide and Rodenticide Act, 7 U.S.C. §136 *et seq.*, those provisions promoted procompetitive objectives unquestionably within the power of Congress, and thus advanced legitimate public purposes. But, as indicated in *Midkiff*, where *no* such public purposes exist and the government's action operates only to convey private benefits, that action conflicts with the requirements of the Fifth Amendment and must be stricken.

Here, the San Jose City Council explicitly admitted in Section 5701.2[18] that it intended to convey private benefits on certain tenants (emphasis added):

> In order to protect the health, safety and welfare of the citizens of San Jose, this ordinance is a necessary measure designed to alleviate some of the more immediate needs created by San Jose's housing situation. These needs include, but are not limited to the prevention of excessive and unreasonable rent increases, *the alleviation of undue hardship upon individual tenants*, and the assurance to landlords of a fair and reasonable return on the value of their property.

Of these purposes, that of precluding excessive and unreasonable rent increases while assuring landlords a fair return are advanced by Sections 5703.28(a), (b) and (c)(1) through (6).[19] The tenant hardship provisions, on

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[18] See Jurisdictional Statement of Appellants p. A-34.

[19] The burden placed on landlords as a result of rent limitations in furtherance of such purposes is arguably justified on the basis of the "public nuisance" exception to the Fifth Amendment's taking guarantee, *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 107 S.Ct. 1232, 1245 (1987), if one assumes that excessive rents are the result of aberrational market conditions, *i.e.*, demand far in excess of supply. This conclusion assumes that these provisions

(Footnote continued on following page)

the other hand, can have and serve no objective other than to alleviate undue hardships upon individual tenants. Since that is a wholly private rather than public benefit, and not even a private benefit ancillary to a larger public purpose, as in *Midkiff* and *Monsanto*, the tenant hardship provisions of the Ordinance are unconstitutional.

It may be asserted that the City has a legitimate public interest in seeing that less affluent citizens are able to secure adequate housing. By providing purely pecuniary benefits to private individual tenants solely at the landlord's expense, however, the tenant hardship provisions really further only the "public purpose" of preserving the City treasury by compelling landlords to make an indirect contribution to general governmental revenues. Such a transformation of private into public property is "the very kind of thing that the Taking Clause of the Fifth Amendment was meant to prevent." *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 164 (1980).

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[18] *continued*

are necessary to preclude landlords from creating the "public nuisance" of extracting exorbitant rents as a result of such conditions, at the expense of tenants. No analogous justification exists for the tenant hardship provisions, however. To the extent that a given tenant is unable to pay a landlord that which pursuant to the City's ordinance has been determined to be a reasonable rent, that circumstance is not created, exaggerated or otherwise effected by the landlord, and no governmental action is necessary to deter him. Thus, the "public nuisance" exception cannot be applied to sustain Sections 5703.28(c)(7) and 5703.29. *See also, Goldblatt v. Hempstead*, 369 U.S. 590 (1962); *Miller v. Schoene*, 276 U.S. 272 (1928); *Mugler v. Kansas*, 123 U.S. 623 (1887).

C. The Tenant Hardship Provisions Are Unconstitutional Because They Impose On Private Parties An Excessive Public Burden.

Even if this Court were to conclude that the purely private interests served by the tenant hardship provisions also further some public purpose, those provisions nevertheless fail to survive Fifth Amendment scrutiny. The redistribution of rent from the landlord to the tenant as a result of application of those provisions "necessarily requires a weighing of private and public interests." *Agins v. Tiburon*, 447 U.S. 255, 261 (1980); *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 107 S.Ct. 1232, 1246 (1987). Application of the tenant hardship provisions to reduce the rent from a level otherwise determined under the Ordinance to be reasonable effects a taking unless it is determined that it is just for the property owners, rather than the public at large, to "bear the burden of (this) exercise of state power in the public interest." *Agins*, 447 U.S. at 260. Because the public interest served by these provisions is, at best, tenuous, and because the burden for serving that interest is most properly imposed on the public, rather than solely on the landlords, the tenant hardship provisions must for this reason also be invalidated.

This Court has repeatedly acknowledged the difficulty of establishing a "set formula for determining when justice and fairness require that economic injuries caused by public action be compensated by the government, rather than remain disproportionately concentrated on a few persons." *Kaiser Aetna v. United States*, 444 U.S. 164, 175 (1979), *Penn Central Transportation Co. v. New York*, 438 U.S. 104, 124 (1977), *Goldblatt v. Hempstead*, 369 U.S. 590, 594-95 (1962). Several factors relevant to that inquiry have been identified, however, including interference with distinct investment-backed expectations and the character of the governmental action at issue. *Id.* Both these considerations, as well as ordinary principles of fairness, suggest that the balancing of private and public interests in this case weighs heavily in favor of invalidation of the tenant hardship provisions.

First, the reasonable and distinct investment-backed expectations of apartment owners in San Jose, like those of property owners everywhere, is to earn a fair return on their investment in the buildings they own. The tenant hardship provisions not only interfere with but obliterate those expectations. Because the tenant hardship provisions reduce the rent below that determined under the Ordinance to be fair and reasonable, the apartment owner receives only a rent which is, by definition, unreasonable and unfair. His expected and constitutionally protected fair return on his investment is denied.

Second, the character of the action of the City Council equally compels the conclusion that an impermissible taking has occurred. By simply converting the landlord's property—a portion of the reasonable rent—to the tenant, the tenant hardship provisions resemble the "physical invasion" cases where a taking is found almost automatically, *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 434 (1982), *Kaiser Aetna*, 444 U.S. 164, 180 (1979), *United States v. Causby*, 328 U.S. 256 (1946), rather than the "diminution in value" cases, where a taking is generally not found. *Keystone Bituminous Coal Ass'n*, 107 S.Ct. at 1246, *Andrus v. Allard*, 444 U.S. 51, 66 (1979), *Penn Central*, 438 U.S. at 131. The impact on the landlord resulting from the tenant hardship provisions is simply a diversion of his money to the tenant, just as surely as if the City had attached his bank account and used his money to subsidize certain tenants deemed to be deserving. Like this Court's decision in *Webb's Fabulous Pharmacies v. Beckwith*, 449 U.S. 155 (1980), where this Court found an unconstitutional taking when the state diverted to itself investment income on funds placed into interpleader, the San Jose City Council should not be permitted effectively to appropriate a portion of the reasonable rent due a landlord owner for payment over to the tenant.

Finally, it is fundamentally unjust to compel private landlords to be the sole source of rent subsidies to be provided to those tenants the City Council deems to be in need of such assistance. To the extent such assistance furthers societal objectives viewed important, those objectives merit the expenditure of City funds derived from all citizens who will benefit from the achievement of such objectives. If, on the other hand, those objectives do not warrant the use of municipal resources, the inequity of requiring private individuals to fund those public purposes is underscored. Indeed, the injustice of obligating landlords to finance the pursuit of those objectives is further emphasized by the empirical experience and research discussed in Section I *supra*. That data demonstrates inescapably that imposition of rent control results in the decay and eventual elimination of adequate, well-maintained rental housing in a community, thus defeating the very objectives the City seeks but for which it is unwilling to pay. A more anomalous result could hardly be imagined.

Since even if the tenant hardship provisions can be said to further legitimate public purposes, they do so by imposing burdens which fail to strike a fair and proper balance between private and public interests, and therefore are for this reason also unconstitutional.

CONCLUSION

The principal issues in this case is the constitutionality of the tenant hardship provisions of the San Jose Rental Dispute Mediation and Arbitration Ordinance. Those provisions infringe the Fifth Amendment rights of landlords in San Jose, and must be stricken.

Additionally, however, this case provides the Court the opportunity to acknowledge and incorporate into the standard of review applicable to rent control ordinance challenges what years of experience have unquestionably demonstrated: rent control ultimately strikes a fatal blow to the well-being of the communities and citizens it is intended to benefit. NAR urges this Court to seize this opportunity to promote the welfare of America's tenants by respecting these immutable facts and directing other courts to recognize their reality when considering future challenges to rent control ordinances.

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AMICUS CURIAE

BRIEF

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⑮

No. 86-753

IN THE

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OCTOBER TERM, 1986

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Appellants,

vs.

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THE CITY OF SAN JOSE,
Appellees.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF CALIFORNIA

BRIEF AMICUS CURIAE OF THE NATIONAL APARTMENT ASSOCIATION and THE CALIFORNIA APARTMENT ASSOCIATION IN SUPPORT OF APPELLANTS

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INTEREST OF AMICI CURIAE

Pursuant to Supreme Court Rule 36.2, the National Apartment Association and the California Apartment Association respectfully submit this brief amicus curiae in support of plaintiffs and appellants, Richard Pennell, et al. Written consent to the filing of this brief has been granted by counsel for all parties and lodged with the Clerk of this Court.

Amicus Curiae National Apartment Association is a nonprofit association which, together with its state and local affiliates, represents the interests of all owners, developers and operators of residential rental properties who provide shelter for more than 30 million households in this country. National Apartment Association is the only nationwide trade association that represents exclusively the interests of the multifamily rental housing industry. Because the National Apartment Association represents the interests of the rental housing industry and its members on a national basis, it has an interest in all issues relating to rental housing.

Amicus Curiae California Apartment Association represents the interests of the more than 352,000 owners of residential rental property in California, the majority of whom have their savings invested in modest holdings of four units or less, who provide shelter for over 4 million households in the State of California. Because this case arises from California, and because California unfortunately is the breeding ground of the nation's most egregious and confiscatory assaults upon the rights of private landowners, California Apartment Association and the industry it represents have a direct and vital interest in this case.

INTRODUCTION

The quality and adequacy of housing as well as the economic condition of the housing industry in the United States are important national concerns. In the Housing Act of 1949, Section 2, 42 U.S.C. 1441, Congress enacted a Declaration of National Housing Policy:

> The Congress hereby declares that the general welfare and security of the Nation and the health and living standards of its people require housing production and related community development sufficient to remedy the serious housing shortage, the elimination of substandard and other inadequate housing through the clearance of slums and blighted areas, and the realization as soon as feasible of the goal of a decent home and a suitable living environment for every American family, thus contributing to the development and redevelopment of communities and to the advancement of the growth, wealth, and security of the Nation. The Congress further declares that such production is necessary to enable the housing industry to make its full contribution toward an economy of maximum employment, production, and purchasing power.

This policy was reaffirmed in the Housing and Urban Development Act of 1968, P.L. 90-448, 42 U.S.C. 1441. Any housing policy having the potential of broad effects throughout the rental housing industry is of grave concern to that national housing policy. Rent control in its various forms and in this case in particular presents such an issue, for the opinion below sanctions a radical broadening of the purpose of rent control to encompass restrictions on rent upon factors, never before accepted by the courts, unrelated to the objective determination of a "reasonable rent." This case is not limited in its effects to the City of San Jose, California; it will determine whether lessors throughout the Nation may, at the whim of local officials, be assessed even further denials of income in response to social evils wholly unrelated to their own economic activity.

Rent control is a critical housing issue. The impact upon the housing supply in communities that adopt rent control ordinances is well documented and devastating. Rent control leads to the deterioration of quality and quantity of the rental housing stock in areas subject to its stifling effects, by driving investors away from those markets and communities and creating disincentives to existing owners to reinvest in existing properties.

The adverse impact of rent control has prompted Congress to act to limit rent controls lest they interfere with federal housing programs. In the Rental Housing and Urban-Rural Recovery Act of 1983, P.L. 98-181, Congress by express preemption exempted from state or local rent controls, with certain exceptions, any rental residential property constructed or rehabilitated under the federal rehabilitation and development grants program created thereby. P.L. 98-181, Section 17, 42 U.S.C. 1437o.

In 1975, acting under the authority granted to it by Congress, the Department of Housing and Urban Development (hereinafter HUD) established its authority to exempt by preemption from local rent controls properties that it insures, subsidizes or owns, 24 C.F.R. 403, recognizing that such controls jeopardize the financial integrity of the property and thereby HUD's economic interests therein—just as they jeopardize those of the private investors whom Congress by its Declaration of National Housing Policy seeks to encourage to produce housing for America.

The President's Commission on Housing was created in 1981 to analyze housing in America and make recommendations for the further development of national housing policy. The Commission's report dealt specifically with rent control and made the following findings and recommendations:

> Rent Control: The Commission finds that rent control causes a reduction in the quality of the existing rental housing stock and discourages investment in new rental property. Therefore, the Commission opposes, in principle, rent control at Federal, State, and local levels.
>
> * * *
>
> State Actions: The adverse effects of rent control spread far beyond the boundaries of municipalities. Therefore, the Commission urges that states pass legislation removing the power of counties, cities, and all other local jurisdictions to adopt ordinances controlling rents.
>
> * * *
>
> Federal Actions: The Commission recommends that the Federal government should preempt the application of any State or local government rent controls on rental housing financed by a lending institution in which deposits are insured by a Federal Agency, and on rental housing financed by the Federal government or which has a mortgage insured or guaranteed by the Federal government or its agencies. [Report of the President's Commission on Housing (1982), at 91-93.]

It is clear that rent control is disfavored, where not actually preempted, by federal housing policy. Yet it continues to proliferate, due to its direct financial appeal to tenant voters

and its value to local governments as a cheap solution to their own responsibilities to subsidize low-income housing. Rent controls have been adopted in over 200 localities in California, the District of Columbia, Maryland, Massachusetts, New Jersey and New York. If, as the opinion below suggests, municipalities can go beyond the usual formulae for determining a "reasonable rent" and mandate an even lower rent to subsidize constituents who otherwise would become public charges, the entire nation is threatened with an explosion of rent control ordinances as cash-poor cities discover they are empowered to foist their welfare costs upon the rental property lessor minority. Such a result will severely jeopardize national housing policies and ultimately injure those whom rent controls purport to protect by driving housing providers and financiers out of housing in search of more stable investments which are spared from such discriminatory and arbitrary imposition of the public welfare burden which in justice must be borne by the society as a whole.

SUMMARY OF ARGUMENT

Rental property owners in California have suffered wave after wave of municipal enactments designed to shift to the lessor without compensation society's burden of subsidizing tenants who cannot afford to pay market rents. No other class of business has been singled out for such discriminatory treatment, although ostensibly these less fortunate members of society find it equally difficult to afford market prices of food, fuels, clothing, medicines and medical care, and other necessities of life.

Rent control in California has evolved in its 11-year history since the seminal case of *Birkenfeld v. City of Berkeley*, 17 Cal.3d 129 (1976) from an initial ordinance of the City of Berkeley claiming as its purpose the alleviation of exorbitant rents exploiting a housing shortage to ordinances, such as the instant one, which provide for the denial of part or all of a rent increase which even a rent board hearing officer deems otherwise reasonable and justified if, for reasons wholly unrelated to the premises or the lessor's conduct, the tenant cannot afford to pay that otherwise reasonable rent. As a result, the fictional basis for rent control—and it is fictional—that it is a "land use" regulation relating to the use of property and the social effects of that use has been totally abandoned. No longer is the question one of whether the charging of unreasonable rents gives rise to undesirable social effects which can be ameliorated by the exercise of the police power. Instead, such a provision abandons objective determination of reasonable rent and brazenly conscripts the lessor as the alternate treasury of the local welfare department for the correction of general social problems wholly unrelated to his or her own business activity.

Such involuntary transfer of general society's and government's responsibilities to a private party violates the Constitutional guarantees of due process, equal protection and protection from taking of property without just compensation and demonstrates the interplay of those three guarantees through their common thread of fundamental fairness in the workings of society. The transfer of government's traditional burdens—nominated "enterprise functions"—to the private sector, without compensation, constitutes a "taking" of property under the precedents of this and other courts. The arbitrary singling out of a politically disfavored minority class to shoulder the burdens of society not uniquely relating to, arising from or specially benefiting that class or its activities constitutes a denial of equal protection of the laws. Because these arbitrary redistributive purposes depart from the valid scope of the police power, and are fundamentally unfair, they deny due process of law to the victimized owners.

ARGUMENT

I

REDUCTION OF OTHERWISE REASONABLE RENT TO ACCOMMODATE INDIVIDUAL TENANT HARDSHIPS DENIES EQUAL PROTECTION OF THE LAW

The Fourteenth Amendment to the United States Constitution guarantees, at Section 1 thereof, that:

> No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

Appellees' ordinance, reproduced in Appendix E to the Jurisdictional Statement herein, provides at Section 5703.29 thereof that,

> [T]he hearing Officer *shall* consider the economic and financial hardship imposed on the present tenant . . . . If, on balance, the Hearing Officer determines that the proposed increase constitutes an unreasonably severe financial or economic hardship of a particular tenant, he may order that the excess of the increase which is subject to consideration under subparagraph (c) of Section 5703.28, or any portion thereof, be disallowed. Any tenant whose household income and monthly housing expense meets the criteria established by the Housing Assistance Payments Program under section 8, existing housing provisions of the Housing and Community Development Act of 1974 (P.L. 93-383) and the regulations pertaining thereto, shall be deemed to be suffering under financial and economic hardship which *must* be weighed in the Hearing Officer's determination." [Ordinance 19696, Section 5703.29, Appendix E at A-46; emphasis added.]

Subdivision (b) of Section 5703.31 of the ordinance permits a *reduction* of rents pursuant to the criteria set forth in Section 5703.28, which include "the hardship to a tenant," at 5703.28(c)(7). *All* of those criteria, excepting that hardship provision, have some rational nexus to the value and condition of the property, the expense of operating the property, and the lessor's performance of his or her end of the rental relationship. The "hardship" factor, in contrast, addresses a social and personal problem—poverty—no more related to the property than to any other goods or services, and denies the lessor's otherwise reasonable rent in response to this problem, notwithstanding the fact that it is neither a situation of the lessor's making or incidental to the leasing of real property nor one in which the lessor has any unique stake or interest. It is *society's* problem, and society's responsibility which the tenant-dominated majority has politically imposed upon the lessor minority as a financially and politically expedient solution to a financial obligation rightfully that of the entire community, the entire tax base. That isolation of a politically outnumbered and disfavored minority to shoulder society's burden constitutes a denial of equal protection of the laws.

This Court was presented with, and declined to decide, a similar discriminatory shift of a unique burden in *Department of Mental Hygiene v. Kirchner,* 60 Cal.2d 716 (1964), which this Court vacated at 380 U.S. 194 over uncertainty whether California relied exclusively on the Federal Constitution. On remand, the California Supreme Court held that the state constitutional provisions were "substantially equivalent" to the federal equal protection clause, that they would reach the same result under the Fourteenth Amendment, but that they did not act "solely by compulsion of the Fourteenth Amendment," thereby precluding further review in this Court. *Dept. of Mental Hygiene v. Kirchner,* 62 Cal.3d 586, 588 (1965). *Kirchner* dealt with a statute imposing upon relatives of adults involuntarily confined by the state in state mental institutions the duty to subsidize the costs of that confinement, a confinement which the court found to have been caused for the benefit of the public and not to further the interests or perform the duties of its involuntary indemnitor. In *Kirchner* and its progeny the California court has had no trouble recognizing the discriminatory effect of such impositions of the public burden, observing that,

> A statute obviously violates the equal protection clause if it selects one particular class of persons for a species of taxation and no rational basis supports such classification. (Citations omitted.) Such a concept for the state's taking of a free man's property manifestly denies him equal protection of the law. [*Dept. of Mental Hygiene v. Kirchner* (1964) 60 Cal.2d at 722-723, 388 P.2d 720.]

Yet in the opinion below in this case the majority of that court simply refused to recognize that the equal protection principles in *Kirchner* have equal applicability to other statutes which single out a minority class for the bestowal of society's duty. Opinion below, Appendix A to Jurisdictional Statement, at A-7, A-8. We respectfully submit that the correct view is that expressed by the dissenting opinion below, "[O]n the contrary, that *Kirchner* is on all fours with the unusual circumstances of this case: a small class of persons, here landlords of hardship tenants, are required to shoulder what is essentially a public burden, in this case the social necessity of easing the plight of economically depressed citizens." Opinion below, Appendix A, at A-15, A-16.

As the majority of that same court recognized in the case of *In re Jerald C.,* 36 Cal.3d 1, 678 P.2d 917 (1984):

> Such limitation on the government's ability to raise money has been traced to the Magna Carta and the Petition of Right. (Citation omitted.) To charge the cost of operation of state functions conducted for public benefit to one class of society is arbitrary and violates the basic constitutional guarantee of equal protection of the law. [678 P.2d at 919.]

These "responsible relative reimbursement" cases seem to be one of the most commonly litigated variants of government attempts to impose its social welfare responsibilities upon arbitrarily selected minorities. Those cases which have upheld the shift of public confinement costs to relatives have relied upon the direct and vital interest of the family in the patient's care and the "moral obligation" of the family which the states have merely codified as an enforceable obligation. *See, Kough v. Hoehler,* 413 Ill. 409, 109 N.E.2d 177, 181 (1952); *Beach v. Government of District of Columbia,* 116 App.D.C. 68, 320 F.2d 790, 792-3 (D.C. Cir., 1963), cert. den. 375 U.S. 943. Where it can be seen that the activity sought to be subsidized does *not* relate to a unique obligation or interest of the conscripted payor, as in *Kirchner* and *Jerald C., supra,* it follows that government has arbitrarily singled out a minority for enforced subsidization of the public's obligations and interests.

The principles which compel this conclusion are not, as suggested by the opinion below, limited to the "responsible relative" context (*see,* opinion below, Appendix A to Jurisdictional Statement at A-8). It is well-established in the equal protection cases that a classification scheme may not arbitrarily assign burdens or privileges. *Gulf, C. & S. F. Ry. Co. v. Ellis,* 165 U.S. 150 (1897); *Atcheson, Topeka & Santa Fe Ry. v. Vosberg,* 238 U.S. 56, 59 (1915); *State ex rel. Miller v. McDonald,* 260 Ind. 565, 297 N.E.2d 826, cert. den. 414 U.S. 1158 (1974); 16A Am.Jur.2d *Constitutional Law* §753. Any law made applicable to one class of citizens only must be based on some substantial difference between the situation of that class and other individuals to which it does not apply. *Seaboard A.L. Railway v. Seegers,* 207 U.S. 73 (1907). Even California recognizes that where the class singled out has no necessary connection with the evil sought to be prevented, and where the evil can be directly prevented through nondiscriminatory legislation, the statute must be struck down as an invidious discrimination against that class. *Sail'er Inn, Inc. v. Kirby,* 5 Cal.3d 1, 485 P.2d 529 (1971); 16A Am.Jur.2d *Constitutional Law* §755. No burden can be imposed on one class of persons, arbitrarily selected, which is not in like conditions imposed on all other classes similarly situated. *Vigeant v. Postal Tel. Cable Co.,* 260 Mass. 355, 157 N.E.2d 651 (1927), 53 A.L.R. 867. This Court has stated in a general way that the guarantee of equal protection forbids that one class by law be required to suffer losses so that others may make gain. *Covington & Lexington Turnpike Road Co. v. Sanford* 164 U.S. 578 (1896); *Reagan v. Farmer's Loan & Trust Co.,* 154 U.S. 420 (1894). As this Court stated in *Reagan,*

> The equal protection of the laws which, by the Fourteenth Amendment, no State can deny to the individual, forbids legislation, in whatever form it may be enacted, by which the property of one individual is, without compensation, wrested from him for the benefit of another, or of the public. [154 U.S. at 399.]

It follows from these principles that if a legislative enactment applies only to one class of persons and imposes upon them duties and burdens not common to others, there must exist in the relations of such persons to the state, to the public, or to individuals some reasonable ground of distinction sufficient to show that the classification is not merely personal and arbitrary, or there will be a denial of the equal protection of the laws. *Nitka v. Western Union Tel. Co.,* 149 Wis. 106, 135 N.W. 492 (1912); 16A Am.Jur.2d *Constitutional Law* §786.

When rent control moves beyond regulation of rents upon objective criteria relating to the premises and market conditions and converts it to a form of general assistance aid on a particularized basis, when government mandates a $50 or $100 per month lower rent on one of two identical adjacent apartments for reasons wholly unrelated to the apartments, the tenancy relationships or the conduct of the lessor, an arbitrary and discriminatory assignment of the burden of subsidizing that tenant has taken place. The requisite rational nexus between the objective and the burdened class tears away at the point where government abandons the fiction of prevention of "unreasonable rents" and declares that "reasonable rent" varies between two identical apartments in the same building because a tenant was laid off, quit his job or was incarcerated. It is offensive enough that lessors are uniquely required to subsidize tenants as a class to the extent of the difference between unregulated market rents and regulated "fair" rents, but the further denial of property for reasons alien to the purported purpose of balancing the bargaining positions of those two classes simply abandons that supposedly rational basis of discrimination and imposes upon a minority the cost of solving a societal problem unrelated to them as a class.

Although not heretofore recognized as a "suspect class," it is submitted that lessors, where singled out and burdened by a tenant majority, bear many of the familiar earmarks of such a class and that such majoritarian predation may be deserving of more careful scrutiny than is generally afforded by the "rational basis" test. The landed minority has historically been a target of majoritarian abuses. Indeed, it is significant that landlords have been singled out for profit deprivation generally, and now specific subsidization of individual tenants, when the prices of food, clothing and other necessities continue to rise uncontrolled, amid unproven and indefensible assertions of unconscionable profit-taking by landlords. This is nothing new. The risk that the unlanded majority would abuse its political power to take unto themselves the property of the minority for essentially private purposes disguised as an alleged public good was a serious concern to our founding fathers and likely provided much of the basis for the due process and compensation protections of the Fifth Amendment. As James Madison wrote in the Federalist Papers:

> Complaints are every where heard. . . that our governments are too unstable, that the public good is disregarded in the conflicts of rival parties; and that measures are too often decided, not according to the rules of justice and the rights of the minor party, but by the superior force of an interested and overbearing majority. . . .
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> . . . [T]he most common and durable source of factions, has been the various and unequal distribution of property. Those who hold, and those who are without property, have ever formed distinct interests in society. . . .A landed interest, a manufacturing interest, a mercantile interest, a moneyed interest, with many lesser interests, grow up of necessity in civilized nations, and divide them into different classes, actuated by different sentiments and views.
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> * * *
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> When a majority is included in a faction, the form of popular government. . . enables it to sacrifice to its ruling passion or interest, both the public good and the rights of other citizens. . . .
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> * * *
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> . . . [In a pure democracy a] common passion or interest will, in almost every case, be felt by a majority of the whole; there is nothing to check the inducements to sacrifice the weaker party or an obnoxious individual. . . .[The Federalist No. 10, at 104-109 (J. Madison)(Hamilton ed. 1868).]

This Court has in the past observed that classifications based upon wealth or property are traditionally disfavored and demand a more exacting scrutiny. *McDonald v. Board of Election Commissioners of Chicago,* 394 U.S. 802, 807 (1969); *Harper v. Virginia Board of Elections,* 383 U.S. 663, 668 (1966); *Edwards v. California,* 314 U.S. 160 (1941). Although such statements have traditionally been made in the defense of the poor, they are after all a recognition of the fundamental historic inter-class tension between those who own property and those who do not, a tension which historically has led to excesses on the part of both groups. It is that type of historic class tension and the accompanying potential for majoritarian abuses which has in the past invoked a more careful level of scrutiny—oft nominated "intermediate review"—of enactments placing special burdens upon classes not quite recognized as "suspect" and rights not quite recognized as "fundamental." See, e.g., *Levy v. Louisiana,* 391 U.S. 68 (1967) (illegitimate children); *Craig v. Boren,* 429 U.S. 190 (1976) (gender discrimination); *In re Gault,* 387 U.S. 1 (1967) (minors).

For whatever reasons, the popular image of the landlord has historically been far less benevolent than that of the other merchants with whom the populace bargains for the necessities of life, which has rendered lessors far more vulnerable to political abuses such as that presented by this ordinance than are any of the other merchant classes. It is respectfully submitted that the social posture of the landlord is, in comparison to that of most economic regulatees, uniquely tainted by classist prejudices such as should invoke at least an intermediate standard of scrutiny of this class legislation whereby government may be called upon to justify the selection of *this* class to bear the welfare burden which is rightfully the obligation of society as a whole. Amici National Apartment Association and California Apartment Association respectfully submit that while the governmental interest in subsidizing the poor is undoubtedly significant, the assignment of that burden to individual lessors in "hardship" cases, by going beyond the "reasonable rent" concept and further reducing what would otherwise be determined to be "reasonable rent" on the basis of factors unrelated to the premises or the tenancy relationship, is an arbitrary and capricious denial of equal protection of the laws. Further, it is a form of invidious discrimination against a historically disfavored minority, a selective imposition of that public burden upon the basis of a classification lacking the "close fit" to the objective pursued which this court has required in such cases. See, Tribe, *American Constitutional Law* 16-30 (Foundation Press, 1978); *Craig v. Boren,* 429 U.S. 190, 197 (1976).

Finally, the "hardship" provision denies equal protection by its arbitrary distribution of disparate effects within the affected class. Providers of low-cost housing will be hardest hit with "hardship" adjustments, while lessors of luxury penthouses ostensibly will largely escape the provision's effects. Such arbitrary treatment within the class is similarly vulnerable to equal protection attack. See, *Property Owners Association of North Bergen v. Tp. of North Bergen,* 74 N.J. 327, 378 A.2d 25, 30 (1977). And, should there be no other means to provide the lessor with a reasonable rate of return on his building, the neighboring tenants will be arbitrarily singled out for the necessary rent increases to achieve that goal (ibid.). As Justice Mosk cogently observed on behalf of the dissenters below, the saddest and most foreseeable result of this scheme is the contraction of the housing supply available to tenants of marginal means, for the threat of "hardship" adjustments places substantial market pressure upon lessors to shift their property and tenant population upmarket through substantial capital improvements (ostensibly recoverable under §5703.28 of the ordinance) or, as Justice Mosk suggests, through closer scrutiny of the financial stability of potential tenants. Opinion below, Mosk, J., dissenting, Appendix A to Jurisdictional Statement at A-16.

II

THE ARBITRARY IMPOSITION OF THE PUBLIC WELFARE BURDEN UPON LESSORS ALONE DENIES THEM DUE PROCESS OF LAW

Equal protection and due process of law are not exclusive of one another, and overlap in many factual instances, which is quite appropriate as both stem from a fundamental American ideal of fairness in government. *Bolling v. Sharpe,* 347 U.S. 497, 499 (1954); *Examining Board of Engineers, Architects & Surveyors v. De Otero,* 426 U.S. 572 (1976). The issue presented by appellees' "hardship" provision invades such an area of overlapping protections because of the arbitrary fashion in which it burdens one party in response to factors wholly unrelated to that party's activity, duties or interests.

The rule of due process as stated in American Jurisprudence, 2d Ed., echoes the foregoing equal protection principles:

> Due process of law is denied when any particular person of a class or of the community is singled out for the imposition of restraint or burdens not imposed upon, and to be borne by, all of the class or of the community at large, unless the imposition or restraint is based upon existing distinctions that differentiate the particular individuals of the class to be affected from the body of the community. [16A Am Jur 2d, *Constitutional Law,* §817.]

Mr. Justice Cardozo, writing for this Court, has characterized the protection of the individual against arbitrary action as the very essence of due process. *Ohio Bell Tel. Co. v. Public Utilities Comm.,* 301 U.S. 292, 302 (1937); see also, *Slochower v. Board of Higher Education,* 350 U.S. 551, 559 (1956).

The expressly stated purpose of appellees' ordinance presents a facade of rational relation to the consequences of appellants' business activities, but the "hardship" provision impermissibly strays from those purposes and imposes additional, unrelated burdens upon owners of residential rental property. The ordinance states, at §5701.2, that,

> In order to protect the health, safety and welfare of the citizens of San Jose, this ordinance is a necessary measure designed to alleviate some of the more immediate needs *created by San Jose's housing situation.* These needs include but are not limited to the prevention of excessive and unreasonable rent increases, the alleviation of *undue hardship upon individual tenants,* and the assurance to landlords of a fair and reasonable return on the value of the property. [Ordinance No. 19696, Sec. 5701.2, Appendix E to Jurisdictional Statement at A-34; emphasis added.]

But of course any "undue hardship upon individual tenants" is not a need "created by San Jose's housing situation," but rather is a need arising from general social conditions for the correction of which appellees, and not appellants, are responsible. Factory closures, layoffs, strikes, inflation and illnesses giving rise to tenant "hardships" are not "created by San Jose's housing situation;" they are general societal problems which tenants bring to the housing situation, not vice-versa. Those extraneous social problems, with their unquestionably tragic personal impacts, impose the same "hardship" upon tenants *everywhere* they are called upon to open their wallets. Yet if a given tenant's household budget comes up $50 deficient each month, appellees would impose upon that tenant's lessor alone a deprivation of income—a "species of taxation", in the words of the California Supreme Court (*Dept. of Mental Hygiene v. Kirchner*, 60 Cal.2d 716, 722)—to make up that difference. This constitutes a denial of due process, arbitrarily singling out one minority group to subsidize that individual's budget deficit which arises from facts and factors unrelated to the tenancy relationship and the alleged "excessive and unreasonable rent increases" which appellees use as their excuse to intervene in that relationship. See, *Myles Salt Co. v. Iberia Drainage Dist.*, 239 U.S. 478 (1916); *Norwood v. Baker*, 172 U.S. 269 (1898).

III

APPELLEES' "HARDSHIP" PROVISION TAKES PROPERTY WITHOUT COMPENSATION BY TRANSFERRING A UNIQUE PUBLIC FUNCTION

A. The Purpose of All Previously Adjudicated Rent Control Ordinances Is the Alleviation of Ill Effects of Housing Shortages and Exorbitant Rents.

California's leading case regarding rent control is *Birkenfeld v. City of Berkeley*, 17 Cal.3d 129 (1976). Therein, at page 160, the California Supreme Court recited the purpose of the ordinance which it subsequently found to be within the municipal police power but unconstitutional on other grounds:

> The charter amendment includes in its stated purposes for the imposing of rent control the alleviation of the ill effects of the exploitation of a housing shortage by the charging of exorbitant rents to the detriment of public health and welfare of the city and particularly its underprivileged groups . . . . The amendment thus states on its face the existence of conditions in the city under which residential rent controls are reasonably related to promotion of the public health and welfare and are therefore within the police powers.

See also, *Carson Mobile Home Park Owners Assn. v. City of Carson*, 35 Cal.3d 184, 189 (1984), at footnote 4:

> As this court noted in *Birkenfeld*, rent controls will be sustained as a proper exercise of police power unless there is a complete absence of even a debatable rational basis for the legislative determination . . . that rent control is a reasonable means of counteracting harms and dangers to the public health and welfare emanating from a housing shortage.' [Citations omitted.] In the present case, the imposition of mobile home rent controls is a rational curative measure designed to counteract the ill effects of a shortage of mobile home spaces which has resulted in a low vacancy rate and rapidly rising space rents'" [*Carson*, *supra*, at p. 189 n.4.]

Amici Curiae National Apartment Association and California Apartment Association assume *arguendo* that in other respects the San Jose ordinance, by considering factors that relate to cost and investment in determining a fair and reasonable rate of return to the landlord, passes the test of *Birkenfeld* and its progeny. The critical distinction of this ordinance is that it goes one step beyond all others by its express purpose to alleviate "undue hardship upon *individual* tenants." Ordinance No. 19606, section 5701.2, Appendix E to Jurisdictional Statement at A-34 (emphasis added).

B. The Purpose of This Rent Control Ordinance Is Not Simply to Alleviate The Ill Effects of a Housing Shortage, But to Provide a Further Subsidy to Individual Tenants.

The ordinance at issue here is unique in one significant respect. Under the provisions of the ordinance, at one stage of the proceedings on an application for rent increase the hearing officer is *required* to consider the needs of impoverished tenants. It is this requirement to which Amici Curiae take exception. There can be no doubt as to the purpose of the section. It is clearly designed to decrease the amount of rent that an impoverished tenant would otherwise have to pay under the more traditional criteria set forth by the ordinance. Instead of deciding what a reasonable rent is, and then considering that amount to be fair and just, the hearing officer, in certain circumstances, *must* adjust the "reasonable" rate downward to accomodate the individual tenant's financial hardship.

The fact that the landlord is required to absorb the amount of otherwise reasonable rent that the tenant cannot afford amounts to a subsidy of the tenant in that amount. We assert that this subsidy is an unconstitutional taking without compensation in violation of both the federal and state constitutions. U.S. Const., Amendment V; Cal. Const., Art I, 19.

As California's First District Court of Appeal correctly decided (see Appendix B), this case falls within the parameters of *Property Owners Association of North Bergen v. Tp. of North Bergen,* 74 N.J. 327, 378 A.2d 25 (1977). A subsidy which allows a certain class of individuals to get a break regarding rent increases can be constitutionally accomplished only on the basis of an overall use of public funds which cost is then distributed among all taxpayers through general taxation.

C. The Result of this "Hardship" Section is an Unconstitutional Taking From the Landlord's Otherwise Reasonable Rate of Return.

The section which forces the hearing officer to consider the individual tenant's financial hardship is inconsistent with the stated purpose of the enactment that "assures landlords a fair and reasonable return on the value of their property." (Ordinance, section 5701.2, Appendix E at A-34). By considering a tenant's financial hardship, the result necessarily must be a lowering of what would otherwise be be determined to be a reasonable amount of rent. Consideration of an individual tenant's financial position is irrelevant, immaterial, and wholly unrelated to the process by which a fair, just and equitable return to the owner ought to be measured. It is submitted that rent control ordinances, in determining a reasonable rate of return, are limited to considering factors that relate to property value and objectively reasonable rental value. The fortuitous or infortuitous—and wholly arbitrary—circumstances that place an impoverished tenant on a particular landlord's property have nothing to do with the landlord's entitlement to a fair and just return on his property. Once the societal objective of prohibiting excessive rents is achieved by limiting the free market rate to a "fair" return on property value, a further reduction in any amount and for any purpose is necessarily a "taking" which requires the payment of just compensation.

As was stated by California's First District Court of Appeal in *Cotati Alliance for Better Housing v. City of Cotati* , 148 Cal.App.3d 280, 296 (1984):

> We emphasize that the purpose of rent control is not to make the landlord a private guarantor of affordable housing for tenants, nor is it to bring about such a degree of decreased maintenance and services as to diminish the quality of housing available. The purpose of rent control is to permit an efficient landlord to pay all actual and reasonable expenses and receive a fair profit while, at the same time protecting the public interest in having affordable and properly maintained rental housing available to the citizens of the community. [*Cotati, supra,* at p. 296.]

The instant ordinance, with its "hardship" provision, deviates from the *Cotati* standard by making the landlord "a private guarantor of affordable housing". *Cotati, supra.*

The municipal appellees have sought to sustain the instant ordinance by reliance upon a line of cases highlighted by the

Permian Basin Rate Cases 390 U.S. 747, 749 (1968), holding that agencies are to consider "financial and other requirements of the pertinent parties" in determining rates. We assert that these case are not on point at all. *Permian Basin*, and the line of cases upon which the city relies are rate-fixing cases. These are vastly different from public controls of private providers of rental housing. "In particular, it should be noted that constitutional challenges to rent leveling ordinances are not rate-fixing cases. Court should not be concerned with balancing competing interests and determining what is the 'best' rate level. Rather their sole task is to determine the lowest constitutionally permissible rate." *Troy Hill Village v. Township Council*, 68 N.J. 604 (1975), disapproved on other grounds in *Helmsley v. Borough of Fort Lee*, 78 N.J. 200 (1978).

The suppression of rent on one unit in a building containing many such units, in response to one tenant's "hardship," leads to arbitrary and capricious results which are not rationally related to "counteracting harms and dangers to the public health and welfare emanating from a housing shortage." *Carson, supra*, 35 Cal.3d 184, 189 n. 4. It is one thing to regulate rents on the basis of objective criteria inherent in market conditions and the cost of operation; it is quite another thing to adjust such a determination again to alleviate an individual hardship arising from a broader social problem and only tangentially related to the tenancy relationship. For example, a hypothetical owner may own four units, occupied by four microelectronics executives, one of them recently unemployed. The market value of each unit is the same. Debt service, taxes, insurance, maintenance, and such are proportionally the same for each. All the other criteria set forth in the ordinance may be the same as to each. Yet, should that landlord apply for an increase on those units beyond the threshold amount, the unemployed tenant's recent discharge ("hardship") comes into play under the ordinance, and the increase should be granted, if at all, as to three units and denied as to the fourth. The landlord is denied property *not* because of anything inherent in the market, in the premises, or in his management of the premises, but because of the arbitrary happenstance that it was *his* tenant who was laid off.

The rule of *Birkenfeld* and its progeny is that rent control is constitutionally valid where rationally related to protection of society as a group from unreasonable rents. Appellees' ordinance seeks to protect *individuals* from *reasonable* rents they cannot afford to pay due to their personal hardship. This does naught to protect society from unreasonable inflation in rents; it is not rationally related to such purpose. It renders the concept of "reasonable rent" arbitrary and meaningless to say that what is reasonable depends on whether the tenant lost or quit his job.

As the California Supreme Court stated in *Birkenfeld*,

> The charter amendment declares that its rent control provisions are intended to counteract the ill effects of "rapidly rising and exorbitant rents exploiting [the housing] shortage." (§1.) The provisions are within the police power if they are reasonably calculated to eliminate excessive rents and at the same time provide landlords with a just and reasonable return on their property. However, if it is apparent from the face of the provisions that their effect will necessarily be to lower rents more than could reasonably be considered to be required for the measure's stated purpose, they are unconstitutionally confiscatory. (*Power Comm'n v. Pipeline Co.* (1942) 315 U.S. 575, 585-586 [86 L.Ed 1037, 1049-1050, 62 S.Ct. 736]; *Hutton Park Gardens v. Town Council*, supra, 68 N.J. 543, 565-571 [350 A.2d 1, 13-16].) [*Birkenfeld, supra*, 17 Cal.3d 129, 165.]

In the instant case, the plain purpose and effect of the "hardship" provision is to suppress some rents "more than could reasonably be considered to be required for the measure's stated purpose" (*Birkenfeld, supra*), and thus it is unconstitutionally confiscatory.

This is not to say that it is an impermissible public purpose to lend a helping hand to the disenfranchised; but, rather, that to accomplish that purpose by taking value from A and transferring it to B in furtherance of that purpose, rather than aiding B through general taxation, is a compensable taking. *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229 (1984); *Property Owners Association of North Bergen v. Tp. of North*

Bergen, 74 N.J. 327, 378 A.2d 25 (1977). In *North Bergen* the Supreme Court of New Jersey addressed an ordinance similar to the instant one in that it restricted rent increases as to a special class of tenants (those over 65 years of age with annual household income under $5,000) as distinguished from all other tenants. As the New Jersey court quoted with approval, the trial court therein held this to be confiscatory on the following basis:

> Now more importantly, however, the Ordinance is unconstitutional as a deprivation of property without due process of law. By this Ordinance the Municipality seeks to establish a special subsidy for those who the fathers, the Legislative fathers of the Municipality think should get a break in connection with rent increases. This is a fine reason and something to be applauded. However, this can be constitutionally done only on the basis of an overall use of public funds which then is distributed among all the taxpayers by virtue of taxation. And so we have that in [m]any types of legislation which counsel has cited where the burden rests upon the entire community, in which event special treatment of people in need is fully justified and constitutional. We have it from welfare up. We have senior citizen housing. We have other types of legislation which are properly protective of the rights where need appears [f]or special categories of persons. However, in every one of these instances the burden supporting these people partially, of granting them a subsidy, is a public burden and should be borne by the entire community. Here, however, the municipality undertakes to attempt to shift its burden, that is the burden of all the citizens and taxpayers of the Municipality, to a particular class of individuals, namely, persons who own property, and demand that those persons take care of the needs of the community as a whole. That to my mind constitutes a clear-cut taking of property without due process. Selecting a particular class of people in the community to subsidize another class of people in the community is hardly constitutional in its approach. [*North Bergen, supra*, 378 A.2d at 27-28.]

See also, *Armstrong v. U.S.*, 364 U.S. 40 (1960), wherein this Court held that the Fifth Amendment's

> [G]uarantee that private property shall not be taken for a public use without just compensation was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." [*Armstrong v. United States*, 364 U.S. 40, 49 (1960).]

National Apartment Association and California Apartment Association respectfully urge the Court to recognize that the consideration of the personal finances of the tenant under the instant rent control ordinance constitutes an unconstitutional taking without compensation of those amounts to which the landlord would be otherwise entitled.

D. The "Hardship" Requirement, Assertedly Enacted For the Benefit of Society, Causes Landlords to Bear the Cost of a Government Enterprise Function.

The regulation at issue here forces landlords to subsidize the unique financial difficulties of individual tenants and includes a presumption of relief for those entitled to the government's own subsidy. The ordinance provides that:

> Any tenant whose household income and monthly housing expense meets the criteria established by the Housing Assistance Payments Program under Section 8, existing housing provisions of the Housing and Community Development Act of 1974 (P.L. 93-383) and the regulations pertaining thereto, shall be deemed to be suffering under financial and economic hardship which must be weighed in the Hearing Officer's determination. [Ordinance, Appendix E at A-46.]

A review of Title II of the Housing and Development Act of 1974 (42 U.S.C. 1430 et seq.) demonstrates that government has acknowledged its financial responsibility to alleviate the social and individual harms created by the lack of adequate housing for the poor through assistance payments to subsidize low-income housing. The government of the State of California has also recognized its responsibility in providing adequate rental housing to the low-income families of California. In the California Health and Safety Code, an entire division (covering sections 50000 to 51900) is dedicated to public assistance in low-income housing and home finance.

This function, undertaken by the state, is an example of an "enterprise" function, designed to fund a need perceived by the Legislature. It is not simply the regulation of competing private interests; indeed, the California Legislature specifically found that the private market could not address these needs. Instead, the legislature has mandated that the government, acting as an enterprise, assist in alleviating the ill effects caused by the shortage of rental housing.

In attempting to meet its obligation, the California Legislature also enacted Article 10.6 (commencing with section 65580) of the California Government Code. The Legislature made the finding that "the provision of housing affordable to low- and moderate-income households requires the cooperation of all levels of government" Cal. Govt. C. Section 65580(c). Further, subdivision (d) states that "Local and State governments have a *responsibility* to use the power vested in them to facilitate the improvement and development of housing to make adequate provisions for the housing needs of all economic segments of the community." (Emphasis added.) In light of their responsibility, the state also has provided that a unit of local government, in "adopting a requirement in its housing element that a housing development contain a fixed percentage of affordable housing units, shall permit a developer to satisfy all or a portion of that requirement by constructing rental housing at affordable monthly rates, as determined by the local government." Cal. Govt. C. Section 65589.8.

It is thus clear that all levels of government—federal, state, and local—have recognized in varying degrees their obligation to provide adequate housing, including rental housing, to their impoverished constituents. Indeed, in implementing its responsibilities under these laws, the City of San Jose has expressly tied its hardship provision to the standards of the Federal Housing and Community Development Act of 1974. Ordinance, Appendix E, sec. 5703.28.

These examples demonstrate that all levels of government have accepted the burden of financially assisting individuals to alleviate the ill effects of housing shortages. Where the government shifts to a private party the costs of an "enterprise" function a resultant taking is compensable. *Pratt v. State Dept. of Natural Resources* 309 N.W.2d 767 (1981). The governmental enterprise function is defined as being uniquely public in nature, and includes those functions and activities where the government has in the past functioned as a provider or facilitator of goods and services. See, *Penn Central Transp. Co. v. New York City,* 438 U.S. 104 (1978), rehearing denied 439 U.S. 883; Sax, *Takings and the Police Power,* 74 Yale L.J. 36 (1964).

For instance, zoning is generally considered to be "arbitral" in nature, providing a balance and order to potentially competing private interests. Where the government acts in an arbitral position to regulate between two competing private interests, many courts have held that any resultant losses are noncompensable. However, when special open space zoning around a municipal airport is enacted to avoid noise condemnation suits (and thereby save government money), this function is entrepreneurial, and therefore must be compensated. See, *Armstrong v. United States,* 364 U.S. 40 (1960), and *Sneed v. County of Riverside,* 218 Cal.App.2d. 205 (1963).

In *Penn Central, supra,* this Court dealt with New York City's Landmarks Preservation Law as it was applied to the Grand Central Terminal in Manhattan. Plaintiffs had proposed to build a high-rise structure atop the Terminal, which proposal the city rejected for aesthetic reasons pursuant to its Landmark Law. In upholding the city's power to do so, the Court distinguished landmark preservation, an "arbitral" function, from the use of the police power to impose a use restriction on property to facilitate uniquely public or "enterprise capacity" functions:

> Finally, government actions that may be characterized as acquisitions of resources to permit or facilitate uniquely public functions have often been held to constitute "takings." *United States v. Causby,* 328 U.S. 256 (1946), is

> illustrative. [*Penn Central, supra,* 438 U.S. at 128.] Appellant's final broad-based attack would have us treat the law as an instance, like that in *United States v. Causby,* in which government, acting in an enterprise capacity, has appropriated part of their property for some strictly governmental purpose . . . [t]he Landmarks Law neither exploits appellant's parcel for city purposes nor facilitates nor arises from any entrepreneurial operations of the city. [Id., at p. 135.]

Unlike landmark preservation or general zoning, the arbitrary imposition of "hardship"-initiated rent ceilings is not an arbitral function setting forth general regulation, but a complement to the City of San Jose's "uniquely public" function of public assistance to needy citizens. Rent control over *all* rental residences may arguably be "arbitral" in that it benefits the entire renting public in the community and addresses the general welfare problems of scarce supply and rapidly rising rents, but the instant "hardship" provision targets for relief a specific, designated class of individuals who are also the beneficiaries of "uniquely public" assistance programs. By foisting the burden of subsidization of that target group onto the landlord and/or the "non-hardship" tenants, this provision directly facilitates the objectives of a government enterprise, the government's public housing assistance programs enumerated *supra.* It is just as if the city, in lieu of writing a general assistance or rent subsidy check to the hardship victim, had ordered the landlord to write the check himself.

As stated by this Court, the Fifth Amendment's

> [G]uarantee that private property shall not be taken for a public use without just compensation was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." [*Armstrong v. United States,* 364 U.S. 40,49 (1960).]

Amici Curiae assert that the "hardship" section of the San Jose rent control ordinance, by depriving landlords of what would otherwise be a reasonable rate of return, is a taking that requires compensation in that it requires private individuals to shoulder a burden that was heretofore assumed by the government in its "enterprise" function as a provider of housing subsidies.

The Supreme Court of Minnesota came to the same conclusion in a case that involved a similar legal scenario. In *Pratt v. State Department of Natural Resources,* 309 N.W.2d 767 (1981), Pratt was a wild rice farmer in Minnesota. In 1980, the state, acting to discharge a "moral obligation" to the Indians, and as an alternative to direct subsidies, passed a law prohibiting the use of mechanical harvesters on certain lands. The purpose was to force farmers to hire the Indians to hand-harvest the rice. Although this was more expensive to the farmer, the result was to decrease state costs of subsidizing the Indians while still providing the aid to these individuals which the state desired. Perceiving that the state had placed its own responsibility upon the shoulders of the farmers, the Minnesota Supreme Court ruled this to be an enterprise function which, when delegated to an involuntary private party, became a compensable taking.

Amici Curiae National Apartment Association and California Apartment Association contend that appellees have placed their own responsibility to subsidize needy tenants upon the unwilling shoulders of the lesssors. As in *Pratt,* absent compensation, this transfer of government's uniquely public function is an unconstitutional taking.

CONCLUSION

The courts have held that rent control is within the police power where reasonably related to the prevention of unreasonable and excessive rents. Amici Curiae accept *arguendo* that principle, despite the discriminatory nature of controlling rents alone in a free market, because this case presents an even more troublesome spectre. The California Supreme Court has declared that what would otherwise be determined under the previously tested criteria of "reasonable rent" determinations to be a fair rent may be further reduced to accomodate tenant hardship unrelated to the tenancy. This shift away from the assertedly fictional purpose of preventing "excessive" rents to overt imposition of the city's welfare budget responsibility constitutes a very real danger to the rental housing industry should this court uphold that extension of rent control.

Such a transfer of the welfare burden to private parties not uniquely responsible therefor by virtue of their own duties or economic activities violates Constitutional guarantees of due process, equal protection of the laws, and freedom from the taking of property without compensation therefor. It threatens to substantially increase the public subsidization burden already unfairly inflicted upon this industry and by doing so threatens the rental housing supply of this Nation. Amici Curiae National Apartment Association and California Apartment Association respectfully urge the Court to reverse the judgment herein of the California Supreme Court.

DATED: May 18, 1987

Respectfully submitted,

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AMICUS CURIAE

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No. 86-753

IN THE
Supreme Court of the United States
OCTOBER TERM, 1986

RICHARD PENNELL, and
TRI-COUNTY APARTMENT HOUSE OWNERS ASSOCIATION,
Appellants,
v.

CITY OF SAN JOSE and CITY COUNCIL OF
THE CITY OF SAN JOSE,
Appellees.

On Petition for a Writ of Certiorari to the Supreme Court of the State of California

BRIEF OF THE AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS AS *AMICUS CURIAE* IN SUPPORT OF APPELLEES

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On Petition for a Writ of Certiorari to the Supreme Court of the State of California

BRIEF OF THE AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS AS *AMICUS CURIAE* IN SUPPORT OF APPELLEES

This brief *amicus curiae* is filed by the American Federation of Labor and Congress of Industrial Organizations ("AFL-CIO") with the consent of the parties, as provided for in the Rules of the Court.

INTEREST OF THE *AMICUS CURIAE*

The AFL-CIO is a federation of 89 national and international unions with a total membership of approximately 13,000,000 working men and women. The AFL-CIO and its affiliates and their members have a strong interest in the constitutional standards applicable to the power of local, state, and federal government to regulate housing in a way that protects tenants, as a particular matter, and to engage in economic regulation, as a general matter.

ARGUMENT

Introduction and Summary of Argument

The City of San Jose has, through its duly constituted and democratically selected governmental bodies, enacted an ordinance "designed to alleviate" what those bodies consider to be "some of the more immediate needs created by San Jose's housing situation." San Jose Municipal Code (hereinafter cited as "S.J. Code") § 5701.2. Those "needs" are described in the ordinance: "prevention of excessive and unreasonable rent increases, the alleviation of undue hardship upon individual tenants, and the assurance to landlords of a fair and reasonable return on the value of their property." *Ibid.* As the means chosen to "alleviate" these needs, the ordinance limits the play of free market forces in the setting of rental increases in San Jose and mandates, for proposed rental increases above a certain level, a regulatory scheme for determining permissible increases.

The issue in this case is not the wisdom as a matter of policy of San Jose's ordinance: this Court's role is not to determine how best to deal with perceived housing problems in San Jose. Rather the question here is whether the Constitution precludes those who are charged with making such policy choices for the City of San Jose from adopting the method of regulation at issue.

In part 1 of this brief we address appellants' due process and equal protection claims. These claims are based on a characterization of the challenged ordinance that is not borne out by its language or structure. On the face of the ordinance—and the challenge here is only to the ordinance on its face—there is no basis for appellants' assertion that landlords will be deprived of a "fair return" on the value of their property, or that individual landlords will be required to "subsidize" impecunious tenants. However, even if appellants' characterization of the ordinance were correct, their due process and equal protection challenges would be without merit. The ordinance meets the well-established requirements for economic regulation; in particular, for the regulation of prices and rents. The ordinance is designed to achieve legitimate governmental objectives, the means employed by the ordinance are rationally related to those objectives, and the ordinance does not arbitrarily discriminate among landlords.

In part 2 we address appellants' takings clause claim. The right to just compensation applies only when there is a "tak[ing]" of "private property." This Court's cases establish that the marginal diminution in rental increase that might be occasioned by the ordinance as a whole, or by the tenant hardship factor in particular, does not constitute a "taking" of "private property." Diminutions in the value of private property caused by government actions of this kind are simply part of the fluctuations in the value of property that occur in an economy in which market conditions are subject to myriad forces and influences beyond the control of individual property owners. "Such changes in value are incidents of ownership. They cannot be considered as a 'taking' in the constitutional sense." *Danforth v. United States*, 308 U.S. 271, 285 (1939).

1. The Due Process and Equal Protection Claims.

Appellants challenge the constitutionality of the San Jose rent control ordinance, in particular the ordinance's provision that in certain circumstances hardship to tenants may be taken into account by a hearing officer in determining a permissible rent increase, on closely related due process and equal protection theories.

Appellants' due process claim in this regard is that "reduction of rents below a reasonable level in order to subsidize the welfare needs of individual tenants is a misuse of the police power to finance the public burden of assisting the poor" (Appellants' Br. at 17), and that "the tenant hardship provisions discriminate against landlords who have the misfortune to be renting to tenants currently suffering financial hardship" (*id.* at 18-19).

Appellants' equal protection claim is that "imposing the welfare burden arising out of the tenant hardship provisions on individual landlords as a one-on-one subsidy rather than on the entire class of landlords or on the public in general through taxation" constitutes arbitrary discrimination (*id.* at 21).

Although appellants phrase their arguments in support of their due process claim and their equal protection claim in various terms, ultimately both rest on the following factual proposition:

> [T]he tenant hardship provisions in the Subject Ordinance . . . operate to reduce rents below the *fair return* level, in order to provide an individual tenant hardship subsidy. [*Id.* at 14, emphasis in original.]

This factual predicate for appellants' claim is *not* established on the record before the Court. Appellants challenge the ordinance on its *face*, not as applied. No instance of application of the tenant hardship provision is before the Court; no landlord is shown to have been limited in making a rent increase due to that provision, much less to have been restricted to a rent increase that does not provide an adequate level of return.

Indeed, given the structure of the San Jose ordinance, at this juncture it is not clear whether the tenant hardship provision will be called into play in actual cases, much less how the provision will work in practice if called into play. The ordinance provides a landlord four optional methods for computing an allowable rental increase. Landlords are entitled to invoke the option that will produce the highest increase. And tenant hardship is a factor under only one of these four options.

Appellants' claims are thus premature at best. And, as we now show, those claims are, moreover, insubstantial because there is nothing on the face of the San Jose rent control ordinance that "operate[s] to reduce rents below the fair return level . . . ," Appellants' Br. at 14.

a. The San Jose ordinance, in the first place, permits a landlord to increase rent by up to eight percent without the need for any hearing process. S.J. Code § 5703.2.

If a landlord seeks an increase of more than eight percent, the ordinance provides two optional computation methods based on formulas designed to protect landlords from bearing the burdens of increasing costs. In the first of these, the ordinance provides that a rental increase of more than eight percent "shall be deemed reasonable" when it "consists only of passing through one or more of the following: (i) costs of capital improvements, (ii) increased costs of maintenance and operation, or (iii) costs of rehabilitation; plus no more than five percent (5%) of the monthly rent. . . ." *Id.*, § 5703.28(a). The second of the ordinance's cost-shifting formulas provides that rental increases of more than eight percent based on "[i]ncreased costs of debt service shall be deemed reasonable" so long as the underlying debt does not exceed seventy percent of the value of the property and "no more than eighty percent . . . of the cost of such debt service is being passed through to the tenants." *Id.*, § 5703.28(b).

Only if a landlord seeks an increase exceeding eight percent *and* exceeding the increase justified by either of the cost-shifting formulas just described does the fourth option of the ordinance come into play. This option calls upon a hearing officer to balance multiple factors in determining whether to approve all or part of the portion of a rental increase that exceeds the highest rental increase justified under the three prior options. The factors are broad-ranging and are designed to permit a focus on the peculiar circumstances of individual landlords. Thus, for example, the ordinance identifies as factors to be considered in the balance: the rental history of the premises including "the presence or absence of past increases, . . . the frequency of past rent increases, . . . the landlord's response to Proposition 13 savings, and . . . the occupancy rate" in comparison with comparable premises in the same general area; the physical condition of the premises, "including the quantity and quality of maintenance and repairs performed during the" prior year; and "any increases or reduction of housing services." *Id.*, § 5703.28(c)(2)-(4). Indeed, one of the factors to be considered in this balance allows a landlord to produce any financial information peculiar to the landlord that might weigh in favor of a rental increase in excess of that allowed by the first three options of the ordinance: "other financial information which the landlord is willing to provide." *Id.*, § 5703.28(c)(5).

It is in this context that the factor of "the hardship to a tenant" may be considered. *Id.*, § 5703.28(c)(7). In other words, it is in a setting in which factors that go to the particular equities of the individual landlord may be weighed in the balance that the hearing examiner may also consider tenant hardship, a factor that goes to the particular equities of the individual tenant.

The ordinance, moreover, does not direct that any factor, including tenant hardship, be given any particular weight, much less a controlling weight. The ultimate determination that is to be based on the listed factors is expressed by the ordinance in the following terms:

> Hearing Officers shall determine whether rent increases are reasonable under the circumstances taking into consideration that the purpose of this Ordinance is to permit landlords a fair and reasonable return on the value of their property while protecting tenants from arbitrary, capricious or unreasonable rent increases, and under certain circumstances, *unjustified* economic hardship. [*Id.*, § 5703.28, emphasis added.]

It is not crystal clear what "*unjustified* economic hardship" means; but, at the least, the phrase shows that the ordinance contemplates that in some circumstances economic hardship to a tenant *may* be justified.

The ordinance's succeeding section then goes on to make it clear that the hearing officer is not required to reduce a proposed rental increase in excess of that which could be justified under the first three options even if the officer finds "that the proposed increase constitutes an unreasonably severe financial or economic hardship of a particular tenant. . . ." *Id.*, § 5703.29. In the event of such a finding, the ordinance states only that the hearing officer "*may* order that the excess of the increase which is subject to consideration under subparagraph (c) of Section 5703.28, or any portion thereof, be disallowed." *Id.* § 5703.29; emphasis added.[1]

In sum, a landlord seeking a *greater* rental increase than the plainly reasonable increases provided for by the first three options may avail himself of the opportunity provided by the fourth option. That option entails a balancing of numerous factors, some of which go to particularized equities favoring an individual landlord, and one of which goes to a particularized equity favoring that landlord's tenants.

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[1] The ordinance provides that certain tenants, who by virtue solely of their monthly income and monthly housing expense meet criteria of need established under specified housing statutes, "shall be deemed to be suffering under financial and economic hardship which must be weighed in the Hearing Officer's determination." *Id.*, § 5703.29. The purpose of this provision is simply to create an unrebuttable presumption of hardship for this class of tenants, relieving members of that class from the obligation of having to prove hardship. The provision does not require the hearing officer to reduce any rental increase that may otherwise be justified.

Appellants' argument, as we have seen, rests on the assertion that consideration of the tenant hardship factor in the fourth option deprives at least some landlords of a "fair return." But the ordinance expressly states that the objective of the balancing process called for in the fourth option is a rental increase that "permit[s] landlords a fair and reasonable return on the value of their property while protecting tenants from arbitrary, capricious or unreasonable rent increases, and under certain circumstances, unjustified economic hardship." *Id.*, § 5703.28. And, the factors on the landlord's side of the fourth option balance, *standing alone*, assuredly support rent increase determinations at a *higher* than fair return level. Finally, there is no reason at this juncture to doubt that the provisions just described will be administered according to their terms and in a systematic and fair manner, with similar cases being treated similarly.

The provision appellants challenge, in other words, is one which involves a balancing of a variety of factors, including factors that offer the landlord the opportunity to present equities unique to him. The ordinance is to that extent fairly characterized as one permitting a landlord to demonstrate "landlord hardship" in an effort to secure a rental increase in *excess* of the minimum fair return level. To permit tenant hardship to be considered as a counterbalancing factor in such a context is not to require that landlords be denied a "fair return," or that individual landlords "subsid[ize]" individual tenants, but only to require that all the equities on both sides be taken into account in determining the "fair return" it is the ordinance's objective to establish.

In the present posture of the case, then, appellants' argument reduces to the notion that due process and/or equal protection require that only the individual landlord's equities, and not those of the landlord's tenants, may be considered in an individualized rent-setting process such as that provided for in the ordinance's

fourth option. That proposition has absolutely no foundation in logic or in precedent.

b. What we have shown thus far is dispositive of appellants' due process and equal protection claims when judged against the ordinance at issue as that ordinance is actually written. For completeness, however, we go on to address appellants' arguments on their own terms, because even if appellants were properly characterizing the manner in which the ordinance is to be applied, their due process and equal protection challenges would be without merit.

In the nature of things when government regulates prices or rents, the result will be different from the prices or rents that would be produced by the same market absent regulation. That is the point of the exercise. Depending on the type of regulation, individual sellers may gain at the expense of individual buyers—or individual buyers at the expense of individual sellers—when the result is compared to that which might obtain in a free market. This Court has long made clear that federal, state, and local governments are free within very wide bounds so to alter the results of the free market:

> Price control, like any other form of regulation, is unconstitutional only if arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt. . . . [*Nebbia v. New York*, 291 U.S. 502, 539 (1934).] [3]

The express purposes of the ordinance here are without doubt proper legislative purposes for the City of San Jose: "the prevention of excessive and unreasonable rent increases, the alleviation of undue hardship upon individual tenants, and the assurance to landlords of a fair and reasonable return." S.J. Code § 5701.2. *See Bowles v. Willingham*, 321 U.S. 503, 513 n.9 (1944) (rent control permissible in order, *inter alia*, "to stabilize prices and to prevent speculative, unwarranted, and abnormal increases in prices and rents; . . . to protect persons with relatively fixed and limited incomes . . . from undue impairment of their standard of living; to prevent hardships to persons engaged in business. . .").

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[3] *See FCC v. Florida Power Corp.*, 107 S.Ct. 1107, 1113 (1987); *Permian Basin Area Rate Cases*, 390 U.S. 747, 768-769 (1968); *Bowles v. Willingham*, 321 U.S. 503, 516-519 (1944); *Block v. Hirsh*, 256 U.S. 135, 157 (1921).

It is equally clear that the means adopted in the ordinance to carry out these purposes are rationally linked to its purposes. The factors applicable within each of the ordinance's four options are all logically related to the ordinance's purposes. In particular, the tenant hardship factor of the fourth option is logically related to the purpose of "the alleviation of undue hardship upon individual tenants."

There is accordingly nothing arbitrary about this ordinance. Nor is the ordinance discriminatory in the constitutional sense. Where permissible rental increases differ from case to case—and from landlord to landlord and tenant to tenant—according to factors rationally related to legitimate governmental purposes, there is no violation of the proscription against discrimination stated in the equal protection and due process requirements of the Constitution. *Woods v. Miller Co.*, 333 U.S. 138, 145 (1948); *Marcus Brown Holding Co. v. Feldman*, 256 U.S. 170, 198-199 (1921).

Appellants suggest that where discrimination between landlords occurs because of factors related to the relative economic conditions of the landlords' tenants, the Constitution is violated. But this Court has long recognized that the interests of consumers are a valid governmental concern in fixing the level of regulated prices. *See, e.g., Permian Basin Area Rate Cases*, 390 U.S. 747, 770, 815 (1968); *Covington & Lexington Turnpike Road Co. v. Sandford*, 164 U.S. 578, 596-97 (1896). The fact that here, when a landlord invokes the fourth option, the ordinance has adopted a mechanism that makes it possible to consider the situation of particular consumers—as well as the situation of particular sellers—does not alter the analysis. The legitimacy of the governmental concern with consumer interests remains the same, and an ability to analyze those interests on an individual basis is rationally related to that concern. Indeed, the ability to tailor rental increases to meet the individual needs of particular landlords and tenants is in many ways preferable to setting prices or rents on an across-the-board basis, since the latter approach necessarily creates inequities in individual cases.[3]

The legislature "need not control all rents or none. It can select those areas or those classes of property where the need seems the greatest." *Woods v. Miller Co., supra*, 333 U.S. at 145. Given that the factors to be applied under the ordinance are all related to legitimate governmental objectives, as long as those factors are applied in the run of cases in a systematic and fair manner, the ordinance does not constitute unconstitutional discrimination.

Finally, appellants suggest that due process is offended because the ordinance in effect works a transfer of property from one private party to another. In the first place, as we have discussed, every price or rent control statute by definition alters in that way the result that would obtain in a free market:

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[3] *See Permian Basin Area Rate Cases, supra*, 390 U.S. at 769 (upholding class-based ratemaking proceedings over contention that Constitution requires assessment of "separate financial position of each member of the class"); *Bowles v. Willingham, supra*, 321 U.S. at 518 ("[H]igh cost operators may be more seriously affected by price control than others. But it has never been thought that price-fixing, otherwise valid, was improper because it was on a class rather than an individual basis").

> [T]he very purpose of fixing maximum prices is to take away from the seller his opportunity to get all that otherwise the market would award him for his goods. This is a constitutional use of the power to fix maximum prices . . . just as the fixing of minimum prices of goods in interstate commerce is constitutional although it takes away from the buyer the advantage in bargaining which market conditions would give him. [*Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 655 (1944) (Opinion of Jackson, J.) (citations omitted).]

As we discuss in more detail in part 2, *infra*, selling at a price that would obtain in an unregulated market rather than at a governmentally controlled price is not ordinarily property in the constitutional sense, nor is the implementation of price control a transfer of property. And, even if price regulation were considered to effect a transfer of property, this Court has made clear that government may require such a transfer from one private party to another as long as the transfer is "rationally related to a conceivable public purpose." *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229, 241 (1984); *see also*, *Berman v. Parker*, 348 U.S. 26, 31-33 (1954).[4] The problem posed in the latter instance is not whether the governmental requirement violates due process, but rather whether the government must give just compensation to the private party deprived of the property; a matter we discuss in part 2, *infra*.

Price and rent control legislation are, to be sure, controversial as a matter of policy. But this Court has recognized that this controversy is properly to be resolved in the legislative process. The Court has stated, "the function of government may often be to tamper with free markets, correcting their failures and aiding their vic-

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[4] In the rent control context, in particular, "what in its immediate aspect may be only a private transaction may . . . be raised by its class or character to a public affair." *Block v. Hirsh*, 256 U.S. 135, 155 (1921).

tims. . . ." *Fisher v. City of Berkeley*, 106 S.Ct. 1045, 1048 (1986). Consistent with the requirements of due process, government may legislate this form of economic regulation as long as the means employed are reasonably related to a proper legislative purpose. The classic statement of the governing principles in this regard is found in *Nebbia v. New York*, *supra*, 291 U.S. at 537-538 (footnote omitted):

> So far as the requirement of due process is concerned, and in the absence of other constitutional restriction, a state is free to adopt whatever economic policy may reasonably be deemed to promote public welfare, and to enforce that policy by legislation adapted to its purpose. The courts are without authority either to declare such policy, or, when it is declared by the legislature, to override it. If the laws passed are seen to have a reasonable relation to a proper legislative purpose, and are neither arbitrary nor discriminatory, the requirements of due process are satisfied, and judicial determination to that effect renders a court *functus officio*. "Whether the free operation of the normal laws of competition is a wise and wholesome rule for trade and commerce is an economic question which this court need not consider or determine." *Northern Securities Co. v. United States*, 193 U.S. 197, 337, 338. And it is equally clear that if the legislative policy be to curb unrestrained and harmful competition by measures which are not arbitrary or discriminatory it does not lie with the courts to determine that the rule is unwise. With the wisdom of the policy adopted, with the adequacy or practicability of the law enacted to forward it, the courts are both incompetent and unauthorized to deal. The course of decision in this court exhibits a firm adherence to these principles. Times without number we have said that the legislature is primarily the judge of the necessity of such an enactment, that every possible presumption is in favor of its validity, and that though the court may hold views inconsistent with the wisdom of the

law, it may not be annulled unless palpably in excess of legislative power.[5]

2. The Takings Clause Claim.

There remains appellants' contention that if the tenant hardship provision results in a reduction in the rental increase that a landlord would otherwise be entitled to under the ordinance, then, under the takings clause of the Fifth Amendment as incorporated into the Fourteenth Amendment, the landlord should be entitled to compensation for the difference.

It is important to put this takings clause issue in its proper perspective. In this case, a rent control regulation is challenged by itself and not in combination with any requirement that the landlord continue to rent his premises, nor indeed in combination with any restriction on the landlord's privilege to abandon the rental business and to make an alternative use of his property. *See F.C.C. v. Florida Power*, 107 S.Ct. 1107, 1112-1113 (1987); *Bowles v. Willingham*, *supra*, 321 U.S. at 517. This is not a case implicating the landlord's property rights "to possess, use and dispose of" his property, *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 435 (1982). Thus, this is not a case involving deprivation of a right akin to the right to physically occupy one's property. *Compare Fresh Pond Shopping*

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[5] *Nebbia* is only a particularized application of the Court's general approach to governmental economic decision making:

> The Constitution presumes that, absent some reason to infer antipathy, even improvident decisions will eventually be rectified by the democratic process and that judical intervention is generally unwarranted no matter how unwisely we may think a political branch has acted. Thus, we will not overturn such a statute unless the varying treatment of different groups or persons is so unrelated to the achievement of any combination of legitimate purposes that we can only conclude that the legislature's actions were irrational. [*Vance v. Bradley*, 440 U.S. 93, 97 (1979) (footnote omitted).]

Center v. Callahan, 464 U.S. 875, 877 (1983) (Rehnquist, J., dissenting from dismissal for want of substantial federal question); Drobak, *Constitutional Limits on Price and Rent Control: The Lessons of Utility Regulation*, 64 Wash. U. L. Q. 107, 120-121 (1986); Note, *The Constitutionality of Rent Control Restrictions on Property Owners' Dominion Interests*, 100 Harv. L. Rev. 1067, 1072-1074 (1987). Rather, because "these regulations do not *require* the landlord to suffer the physical occupation of a portion of his building by a third party," *Florida Power*, *supra*, 107 S.Ct. at 1112 (emphasis in original), but only affect the incidents of the landlord's relations with an invitee, the ordinance is properly analyzed under the standards applicable to pure economic regulation, *id.* at 1113.

Nor, in the posture of this case as it comes to this Court, can it be said that the tenant hardship provision deprives landlords of the opportunity to make a reasonable return on their investment. As we have discussed, *supra* at 5-6, the tenant hardship provision only comes into play when a landlord seeks a rental increase in excess of each of three optional computation formulas that plainly provide a reasonable return.[6] The fourth option, in which the tenant hardship provision may be invoked, is available to landlords who seek an *even greater* increase. And, the hearing officer who makes the determination under the fourth factor is directed to assure "landlords a fair and reasonable return on the value of their property." Nothing on the face of the ordinance requires any different result.

Against that background, appellants' position comes down to one or both of the following propositions: first, the ordinance will result in landlords receiving rental increases less than the increases that would obtain in an unregulated market; second, the tenant hardship provision will result in some landlords receiving lower rental increases than those landlords otherwise would have received if the fourth option did not include a hardship-to-tenants factor.

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[6] These optional formulas provide for: (i) an increase of 8%; (ii) an increase of 5% plus a pass-through of the landlord's costs, including the costs of capital improvements, rehabilitation, and increased costs of maintenance and operation; (iii) an increase based on increased costs of debt service. *Ibid.*

On either premise, appellants' argument fails at the threshold. The right to just compensation applies only when there is a "tak[ing]" of "private property." The kind of marginal diminution in rental increases that may well be occasioned by the ordinance as a whole, or by the tenant hardship factor in particular, does not constitute a "taking" of "private property."

Virtually all governmental regulation, in any form, has some direct or indirect effect on the value of private property or on the income to be derived from private property. Governmental actions as varied as efforts by the Federal Reserve Board to influence interest rates and the money supply, changes in trade policy, adoption of environmental or occupational safety and health restrictions, placement of roads and highways, all may have drastic effects on the value of private property. Diminutions in the value of private property caused by governmental actions of this kind are simply part of the fluctuations in the value of property that occur in an economy in which market conditions are subject to myriad forces and influences beyond the control of individual property owners. No owner of property can be unaware that some regulatory action by government or some action by other private parties may affect the value of the owner's property. "Such changes in value are incidents of ownership. They cannot be considered as a 'taking' in the constitutional sense." *Danforth v. United States*, 308 U.S. 271, 285 (1939). Thus, in *Connolly v. Pension Benefit Guaranty Corp.*, 106 S.Ct. 1018, 1025 (1986), this Court stated:

> In the course of regulating commercial and other human affairs, Congress routinely creates burdens for some that directly benefit others. For example, Congress may set minimum wages, control prices, or create causes of actions that did not previously exist. Given the propriety of the governmental power to regulate, it cannot be said that the Taking Clause is violated whenever legislation requires one person to use his or her assets for the benefit of another.

In sum, a seller has no vested property interest in a level of profit based upon the price that would emerge in an unregulated market. The government is free, in pursuit of a legitimate purpose, to reject the results produced by a free market and substitute a regulated result that balances the interests of the affected private parties in a different fashion. Whether the change in the value of property is caused by such governmental regulation of price or by the actions of private parties that affect the property's market value, the owner of property cannot claim an entitlement to the value of the property as it existed prior to the change. One risk of property ownership in our society is, and always has been, that the property's value may change.

In line with these principles, "[t]his Court has consistently affirmed that States have broad power to regulate housing conditions in general and the landlord-tenant relationship in particular without paying compensation for all economic injuries that such regulation entails." *Loretto v. Teleprompter Manhattan CATV Corp., supra*, 458 U.S. at 440 (citing rent control cases). Indeed, this Court has recently made clear that it is not a "taking" for government to set rental prices that "limit stringently the return recovered on investment, for investors' interests provide only one of the variables in the constitutional calculus. . . ." *F.C.C. v. Florida Power Corp., supra*, 107 S.Ct. at 1113. For purposes of the taking clause, "[s]o long as the rates set are not *confiscatory*, the Fifth

Amendment does not bar their imposition." *Id.* at 1113 (emphasis added).

As we have shown in detail, *supra* at 5-8, 15, there is nothing in the options provided in San Jose's ordinance for setting rental increases that would permit, much less mandate, a confiscatory rental. Indeed, those options are designed to provide landlords a "fair and reasonable return on their investment."

San Jose could, we presume, have opted for an approach that would have spread the cost of protecting tenants' interests among the general population rather than for rent control which, by its nature, tends to some degree to concentrate among a limited group the cost of achieving the public good sought to be achieved. The takings clause, however, does not bar the choice in fact made by the elected officials of San Jose; that being so, under our constitutional system the choice was up to them.

CONCLUSION

For the foregoing reasons, the judgment of the Supreme Court of California should be affirmed.

Respectfully submitted,

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AMICUS CURIAE

BRIEF

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No. 86-753

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Appellees.

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BRIEF OF THE U.S. CONFERENCE OF MAYORS, NATIONAL GOVERNORS' ASSOCIATION, NATIONAL LEAGUE OF CITIES, INTERNATIONAL CITY MANAGEMENT ASSOCIATION, AND NATIONAL ASSOCIATION OF COUNTIES AS *AMICI CURIAE* IN SUPPORT OF APPELLEES

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QUESTIONS PRESENTED

1. Whether the consideration of tenant hardship, in one of four separate methods provided by an ordinance for obtaining rental increases, necessarily constitutes a taking, even though landlords may still obtain a sufficient return on their entire investment, may elect other methods of obtaining rental increases not shown to yield confiscatory results, and, in any event, may receive a reasonable return despite any consideration of tenant hardship.

2. Whether a rent control ordinance that is conceded to advance substantially the public purpose of assisting the poor and that does not violate either equal protection or due process constitutes a taking simply because a broader means of regulation might have been chosen.

3. Whether a rent control ordinance that neither compels the landlord to open the property for rental nor prevents the routine eviction of tenants effects a permanent physical occupation of the property violative of the Takings Clause.

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INTEREST OF THE *AMICI CURIAE*

The *amici* are organizations whose members include state, county, and municipal governments and officials throughout the United States. *Amici* and their members have a vital interest in the legal issues that affect the powers and responsibilities of state and local government.

This case presents another instance of businesses subject to regulation by state or local governments seeking to use the Federal Constitution as a shield against such regulation. It poses a facial challenge on constitutional grounds to a municipal rent control ordinance by landlords who have not been denied any rent increase by the provision of the ordinance that they challenge. Appellants assert, in effect, that the mere consideration of hardship to an individual tenant renders the regulation an uncompensated taking of their property, and denies them equal protection and due process, in violation of the Fifth and Fourteenth Amendments.

This Court has recently considered taking claims in a wide variety of contexts, including restrictions on subdivision development (*MacDonald, Sommer & Frates v. Yolo County*, 106 S.Ct. 2561 (1986)); requirement of subsurface coal support (*Keystone Bituminous Coal Ass'n v. DeBenedictis*, 107 S.Ct. 1232 (1987)); restrictions on building in a flood plain (*First English Evangelical Lutheran Church v. Los Angeles County*, 107 S.Ct. 2378 (1987)); and requirement of public access to the seashore (*Nollan v. California Coastal Comm'n*, 107 S.Ct. 3141 (1987)). Each of those cases, however, involved a claim that the land use regulation denied, or severely restricted, the owner's use of land. The present case involves only the claim that the City's action has reduced the landlord's potential profit from the continued full use of the land.

Amici are concerned that the expansion of the taking concept to the area of economic regulation will subject state and local governments to compensation claims from all businesses that could increase their profits if they were relieved of restrictions on their activity. This concern is heightened by the procedural posture of this case, which presents no more than a facial challenge to a municipal ordinance, based on theoretical speculation unrelated to its application to particular facts. The City, confronted with the national specter of vast increases in the number of homeless persons, has attempted to strike a balance between the needs of tenants and the rights of landlords. That balance cannot be judged unreasonable without evidence that its actual effect is to cause substantial injury to constitutionally protected rights.

Appellants' arguments, although generally dressed up in taking garb, represent no more than an attack on the wisdom of the rent control ordinance. As the Court has recognized in cases under the Due Process and Equal Protection Clauses, all regulation burdens some while benefitting others. To find a constitutional defect in economic legislation simply because it adjusts the benefits and burdens created by an unregulated social evil will jeopardize a great deal of social welfare legislation.

Because of their concern about the outcome of this case, and its implications for all state and local government attempts to address the economic problems of our time, *amici* submit this brief to assist the Court in its resolution of the issues.[1]

STATEMENT OF THE CASE

This appeal arises out of a facial challenge to a provision of the San Jose Rental Dispute Mediation and Arbitration Ordinance ("the Ordinance") that, under certain circumstances, allows consideration of "the hardship to a tenant" in assessing the reasonableness of a proposed rent increase.[2] Two lower California courts held the Ordinance unconstitutional on the basis of the hardship provision. The California Supreme Court reversed.

The Ordinance

The Ordinance at issue here was adopted by the City of San Jose in 1979. At that time, the City found that an "increasing demand" for housing within the City had coincided with a "growing shortage" of such housing.

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[1] Under Rule 36 of the Rules of this Court, the parties have consented to the filing of this brief. Their letters of consent have been filed with the Clerk of the Court.

[2] City of San Jose Ordinance Number 19696, adopted August 7, 1979, § 5703.28. All section references in this brief are to the San Jose Ordinance set forth in Article V, Chapter 7, §§ 5701.1-5706.5 of the Municipal Code of San Jose and reprinted in the Appendix to Appellants' Jurisdictional Statement at A-34 *et seq.*

Ord. § 5701.2; App. A-34.[3] This disparity, as well as inflation and the rising costs of new housing, had led to "substantial upward pressure on residential rents." *Ibid.* The City thus found that the Ordinance was required to address certain "immediate needs," including "prevention of excessive and unreasonable rents"; "alleviation of undue hardship upon individual tenants"; and "assurance to landlords of a fair and reasonable return on the value of their property." *Ibid.*

The San Jose Ordinance applies only to rent increases, not initial rents. The rent for any particular apartment, or other rental unit, is set by agreement between the landlord and tenant.[4] The Ordinance then guarantees the landlord an 8% annual rental increase. *Id.* § 5703.2. If he desires a greater increase, a second formula allows him to "pass through" to the tenant increased costs of certain debt service. *Id.* § 5703.28(b).[5] Still a third formula automatically allows an increase equal to 5% of the previous rent plus a variety of increased costs that may be passed through. *Id.* § 5703.28(a).[6]

The provision challenged in this case comes into play only if the landlord seeks a greater increase than those allowed under the other methods. If the landlord is unable to reach agreement with his tenant on the amount of a larger increase, he may file a petition that sets

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[3] References to "App." in this brief are to the Appendix in the Jurisdictional Statement.

[4] Furthermore, a new base rent is set after each voluntary vacancy. Ord. § 5703.3(b)(1).

[5] The aggregate amount of debt from which the increased costs arise can be no greater than 70% of the value of the property, and no more than 80% of the cost of debt service can be passed through to the tenant. *Id.* § 5703.28(b).

[6] A landlord may pass through to the tenant his costs of capital improvement and rehabilitation, as well as his increased costs of maintenance and operation. *Id.* § 5703.28(a).

forth the proposed increase[7]; the petition is then reviewed by a hearing officer who may allow the entire increase, or any portion of the increase found to be "reasonable under the circumstances." *Id.* at § 5703.28.[8] The determination of "reasonableness" is made by reference to seven factors listed in the Ordinance, including, in some circumstances, hardship to the tenant. *Id.* § 5703.28 (c)(1)-(7).[9] The hearing officer must "tak[e] into consideration that the purpose of this Ordinance is to permit landlords a fair and reasonable return on the value of their property while protecting tenants from arbitrary, capricious or unreasonable rent increases, and under certain circumstances, unjustified economic hardship." *Id.* § 5703.28.

The Ordinance also provides for mediation and arbitration, depending upon the conclusion reached by the hearing officer. If the hearing officer finds the proposed increase unreasonable, he is required to undertake a 30-day mediation process. If the mediation produces no agreement, the hearing officer makes a recommendation regarding a reasonable increase, and the case is referred to an arbitrator. *Id.* § 5703.20. Alternatively, if the hearing officer finds the proposed increase reasonable, the tenant may appeal the decision to an arbitrator. *Id.* §§ 5703.21, 5703.22. In either case, the decision of the arbitrator, based on the factors contained in Section 5703.28, is final. *Id.* §§ 5703.24, 5703.25.[10]

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[7] Alternatively, a tenant who is dissatisfied with a proposed increase may file a petition within ten days of receiving notice of a rent increase from the landlord. *Id.* §§ 5703.6, 5703.9.

[8] In no event is the increase allowed less than the permissible increase under any of the first three methods of calculation. See *id.* §§ 5703.2, 5703.28(c).

[9] The Ordinance requires the tenant to bear the burden of demonstrating tenant hardship. *Id.* § 5703.29. Tenant hardship, however, "must be weighed in the Hearing Officer's determination" where a particular tenant's household income and monthly housing expense meet criteria established under the federal Housing Assistance Payment Program. *Ibid.*; see 42 U.S.C. § 1437f.

The Proceedings Below

Appellants, self-described "owners and operators of residential rental properties in San Jose" (App. Br. at 5), brought this action against the City for declaratory and injunctive relief, alleging that any consideration of tenant hardship works a taking of private property in violation of the United States and California Constitutions. The superior court granted judgment for appellants on the pleadings, finding a taking under both the federal and state Constitutions, and enjoined San Jose from considering tenant hardship under the Ordinance. The California Court of Appeal affirmed the judgment on the multiple grounds that consideration of tenant hardship was "wholly arbitrary," a taking without just compensation, and a violation of the Equal Protection Clause. App. A-19 to A-20.[11] The court suggested in particular that, while San Jose was entitled to alleviate the financial hardship of its citizens, it could do so only by taxation of "all the taxpayers." App. A-21.

The California Supreme Court reversed. The court first rejected appellants' argument, which it thought to have been "abandoned" in any event, that the hardship provision renders the statute "incapable of nonconfiscatory application." App. A-5. The court noted that "[t]he tenant hardship factor . . . comes into play, if at all, only in determining what best accomplishes the dual purposes of the ordinance: (i) protecting tenants from excessive and unreasonable rent increases while (ii) assuring landlords a fair and reasonable return." App. A-6

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[10] The Ordinance prohibits certain retaliatory evictions. Ord. § 5706.1. It further provides that, while a voluntary vacancy serves to remove a unit from coverage by the Ordinance, a 30-day notice eviction does not. *Id.* § 5703.3(b)(2).

[11] The court found that inclusion of the hardship provision "comprises an invalid classification based upon wealth or lack thereof." App. A-20.

n.6. It held that nothing in the Ordinance "*requires* disallowance of any or all of a contemplated rental increase." *Ibid.* (emphasis added). To the contrary, the court concluded, "[t]he hearing officer is required merely to 'consider' and 'balance' the tenant hardship evidence; nothing in the ordinance precludes him from granting an increase necessary to assure the landlord a fair return, and thus avoid confiscatory results *despite* any resulting hardship." *Ibid.* (citation omitted) (emphasis in original).[12]

The court rejected appellants' other challenges as well. It declined to hold that "the ordinance arbitrarily selects those landlords with hardship tenants to bear a burden that should be borne by all of society"[13]; although the court recognized that rent control does involve a form of subsidy from landlords to tenants, it observed: "The possibility that local governments could accomplish the same result through a subsidy from general tax revenues has never been considered a bar to the validity of such legislation (on equal protection or any other ground) . . . ." App. A-8.[14] The court was likewise unpersuaded that disparate treatment of landlords with and without hardship tenants violates equal protection. The court held that the different treatment need have only a rational basis and found it rational for San Jose to choose this means of "assist[ing] only those who need assistance." App. A-10.[15]

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[12] The court disagreed with appellants' contention that the Ordinance established two different "fair return standards," stating: "[T]he ordinance grants all landlords the same constitutional fair return, and simply grants to those whose tenants can afford it an additional increase above that constitutionally required." App. A-5 n.5.

[13] App. A-7. In seeking to establish this proposition, appellants principally relied on *Department of Mental Hygiene v. Kirchner*, 388 P.2d 720 (Cal. 1964), in which the California Supreme Court overturned a state requirement that parents of adults involuntarily confined in state mental institutions pay the expenses of confinement. The California Supreme Court limited that decision, which was based on state law, to its particular context. App. A-8 to A-9.

[14] The court noted that "[i]ndeed, this ordinance appears more finely tailored to local needs than 'across-the-board' rent control: while granting a generous 8 percent automatic increase to all landlords, it offers the potential for even more liberal increases to those whose tenants can bear the additional increase without finan-

INTRODUCTION AND SUMMARY OF ARGUMENT

The City of San Jose, like many cities and towns during the past half-century, has responded to local housing conditions by adopting an ordinance limiting rental increases under certain circumstances. The City, noting "a growing shortage of and increasing demand for housing in the City of San Jose," found that this imbalance, along with inflation and other factors, had "put substantial upward pressure on residential rents." Ord. § 5701.2. In enacting the Ordinance, the City explicitly recognized the need to assure landlords "a fair and reasonable return on the value of their property"; at the same time, it expressed concern about "excessive and unreasonable rent increases" and "undue hardship upon individual tenants." *Ibid.* It carried forward its concern about hardship to tenants by making it one of seven factors to be considered in the event that a landlord seeks a rental increase beyond amounts guaranteed in other provisions.

Appellants raise three principal objections to inclusion of the hardship provision in the Ordinance. All are without merit.

1. The Ordinance does not deny appellants "a just and reasonable return on the value of their property." App. Br. at 6. In claiming otherwise on this facial challenge, appellants have, first, concentrated their attention on the wrong property and, second, taken too limited a view even of that property. The Takings Clause does not guarantee appellants any particular return on individual apartments but requires an assessment of the return on appellants' property as a whole and of the other possible uses of that property. Furthermore, appellants' construction of the hardship provision—that application of the provision must reduce rents below the constitutional minimum—is inconsistent with the language of the Ordinance, its interpretation by the California Supreme Court, and its recent clarification by the San Jose City Council.

2. The Ordinance does not impose a burden on appellants that must be imposed on the public at large. The means chosen by the City to carry out a legitimate public purpose are reasonable, even though they fall somewhat more heavily upon appellants' own property. Appellants are not privileged under the Takings Clause, as they similarly are not under the Due Process or Equal Protection Clause, to rewrite a reasonable ordinance in order to reduce their own obligations and place them on somebody else. Their grievance over the burdens of the Ordinance is not of constitutional dimension.

3. The Ordinance does not amount to a physical occupation of appellants' property. By its terms, the Ordinance applies only to rental increases for units that have already been rented. The initial decision to rent an apartment is made voluntarily by the landlord, and the landlord and tenant set the amount of the initial rent. Moreover, so long as the landlord's primary motivation is not to evade the terms of the Ordinance, he retains substantial control over the eviction of tenants. The limited restrictions placed by the Ordinance on property that has been voluntarily rented are very different from the intrusions deemed to be physical takings by this Court.

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cial hardship. At the same time, and consistent with the ordinance's stated purpose, it provides that the additional rent increase may be denied if doing otherwise would pose a financial hardship to a particular tenant." App. A-9 to A-10.

[15] The court declined to conclude that the disparity in approved rents among landlords was "so great as to be characterized as arbitrary and grossly unfair," holding that such an attack would only be appropriate in a challenge to the ordinance as applied to a particular landlord and a particular tenant. App. A-11.

ARGUMENT

This Court has had frequent occasion in recent years to set out the general guidelines for analysis under the Takings Clause.[16] *See, e.g., Keystone Bituminous Coal Ass'n v. DeBenedictis*, 107 S.Ct. 1232 (1987); *Hodel v. Virginia Surface Mining & Reclamation Ass'n*, 452 U.S. 264 (1981); *Agins v. Tiburon*, 447 U.S. 255 (1980); *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 131 (1978). In so doing, it has pointed out the difficulty of establishing "any 'set formula' for determining when 'justice and fairness' require that economic injuries caused by public action be compensated by the government, rather than remain disproportionately concentrated on a few persons." *Kaiser Aetna v. United States*, 444 U.S. 164, 175 (1979) (citations and internal quotes omitted). As a result, the Court has found it necessary to decide takings cases "by engaging in essentially ad hoc, factual inquiries that have identified several factors—such as the economic impact of the regulation, its interference with reasonable investment backed expectations, and the character of the governmental action—that have particular significance." *Ibid.*

A few general rules nonetheless are clear. It is well-established, for example, that a mere diminution in the value of property is insufficient to demonstrate a taking. *Penn Central*, 438 U.S. at 131; *see Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1926) (75% diminution in value caused by zoning law); *Hadacheck v. Sebastian*, 239 U.S. 394 (1915) (92.5% diminution in value). Furthermore, the fact that "[a regulation] deprives the property of its most beneficial use does not render it unconstitutional." *Goldblatt v. Hempstead*, 369 U.S. 590,

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[16] The only federal constitutional claim alleged in appellants' complaint was a violation of the Takings Clause, and it is the Takings Clause issue that this brief principally addresses. Appellants' due process and equal protection arguments are discussed at note 35 *infra*.

592 (1962). As the Court has recently noted, "[u]nder our system of government, one of the state's primary ways of preserving the public weal is restricting the uses individuals can make of their property." *Keystone*, 107 S.Ct. at 1245. An economic regulation thus will generally be upheld unless it "denies an owner economically viable use of his land." *Keystone*, 107 S.Ct. at 1242 (citations omitted).[17]

These principles suggest, as they should, that takings are not lightly found "'when interference [with property] arises from some public program adjusting the benefits and burdens of economic life to promote the common good.'" *Id.* at 1244 n.18, quoting *Penn Central*, 438 U.S. at 124.[18] The reluctance to find a taking should be greater still when, as in this case, the claim rests largely on the asserted loss of some incremental income. Although there may be an occasional case involving extraordinary exactions, for the most part the loss of some additional benefit or the incursion of some added cost is a common incident of modern economic life; thus, the assertion that a particular obligation unlawfully "takes" property is one that merits considerable skepticism. As this Court long ago recognized, "[g]overnment hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law." *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 413 (1922).

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[17] The Takings Clause also requires that the regulation "substantially advance legitimate state interests." *See Keystone*, 107 S.Ct. at 1242. See pages 23-24, *infra*.

[18] The Court noted that, by contrast, physical intrusions onto property are more likely to constitute a taking. *See Keystone*, 107 S.Ct. at 1244 n.18; *Penn Central*, 438 U.S. at 124; *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982). Although appellants have argued that the Ordinance here does effect a physical occupation (see App. Br. at 28-30; pages 28-30, *infra*), their principal claim is that the hardship provision deprives them of rent to which they are entitled and imposes on them a disproportionate burden.

Appellants' claims face another serious obstacle as well: their challenge is to the Ordinance on its face. Appellants thus must show that its "mere enactment" works a taking of their property, a task properly described as an "uphill battle." *Keystone*, 107 S.Ct. at 1247; *see Virginia Surface Mining*, 452 U.S. at 295; see also App. at A-6 n.6. To succeed, appellants must demonstrate that "no set of circumstances exists under which the Act would be valid." *United States v. Salerno*, 107 S. Ct. 2095, 2100 (1987).[19] "The fact that [an act] might operate unconstitutionally under some conceivable set of circumstances is insufficient to render it wholly invalid, since we have not recognized an 'overbreadth' doctrine outside the limited context of the First Amendment." *Ibid.* Appellants have not come close to meeting this imposing burden.

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[19] This Court upheld rent control in *Block v. Hirsh*, 256 U.S. 135 (1921), holding that a temporary post-war housing emergency clothed the leasing of apartments "with a public interest so great as to justify regulation by law." *Id.* at 155. While the Court has not since ruled on the general validity of rent control, holding only that it can be imposed as a valid exercise of the war power (*see, e.g., Bowles v. Willingham*, 321 U.S. 503 (1944)), the substantive requirement that a business be "affected with a public interest" in order to be subject to economic legislation regulating prices was, of course, eliminated by *Nebbia v. New York*, 291 U.S. 502 (1934). Most modern courts interpret *Nebbia* to have overruled the constitutional requirement that there be an emergency as a prerequisite to rent control. *See, e.g., Birkenfeld v. City of Berkeley*, 550 P.2d 1001, 1019-22 (Cal. 1976); *Hutton Park Gardens v. Town Council of West Orange*, 350 A.2d 1, 7-13 (N.J. 1975); *Eisen v. Eastman*, 421 F.2d 560, 567 (2d Cir. 1969), *cert. denied*, 400 U.S. 841 (1970). This Court has dismissed appeals from challenges to rent control statutes arguably outside the temporary emergency context considsidered in *Block*. *See, e.g., Fresh Pond Shopping Center, Inc. v. Callahan*, 464 U.S. 875, 878 (1983) (Rehnquist, J., dissenting from dismissal of appeal in *Fresh Pond Shopping Center, Inc. v. Rent Control Board*, 446 N.E. 2d 1060 (Mass. 1983)).

I. THE TENANT HARDSHIP PROVISION DOES NOT TAKE APPELLANTS' PROPERTY BY NECESSARILY REDUCING RENTS BELOW A CONSTITUTIONAL MINIMUM

A. The Takings Clause Requires Examination of Both "Property" As a Whole and its Other Possible Uses

Appellants' principal argument is based on the absolute position that "any disallowance or limitation of rental increases resulting from application of the tenant hardship provisions will deprive a landlord of a just and reasonable return on his property." App. Br. at 6. Although appellants do not expressly say so, this position, and the arguments that go with it, seem to assume that a landlord may measure his return against constitutional standards on an apartment-by-apartment basis. The Takings Clause, however, calls for a more searching look into the nature of the property at issue.

It is self-evident that, to determine whether property has been taken, one must first know what the property is. This Court acknowledged last Term that, "[b]ecause our test for regulatory taking requires us to compare the value that has been taken from the property with the value that remains in the property, one of the critical questions is determining how to define the unit of property 'whose value is to furnish the denominator of the fraction.' " *Keystone*, 107 S.Ct. at 1248, *quoting* Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 Harv. L. Rev. 1165, 1192 (1967). The Court has generally been unmoved by property owners' efforts to make that "denominator" into the lowest common one, stating: " 'Taking' jurisprudence does not divide a single parcel into discrete segments and attempt to determine whether rights in a particular segment have been completely abrogated. In deciding whether a particular governmental action has effected a taking, this Court focuses rather both on the character of the action and on the nature of the interference with rights in the parcel *as a whole*." *Penn Central*, 438 U.S. at 130-31 (emphasis added); *see* *also Andrus v. Allard*, 444 U.S. 51, 65-66 (1979) ("where an owner possesses a full 'bundle' of property rights, the destruction of one 'strand' of the bundle is not a taking, because the aggregate must be viewed in its entirety").

We see no reason why appellants' property should be defined, for purposes of takings analysis, in terms of each individual apartment occupied by a tenant invoking the hardship provision; at the very least, the property, taken as a whole, would seem to include the building or complex in which the apartment is located. The investment of a particular landlord is unlikely to be made on the basis of the return from any particular apartment but rather on the return from an entire building or even a complex of buildings. The Ordinance itself reflects this broader inquiry, authorizing the hearing officer to consider the rental history and physical condition "of the rental unit or the complex of which it is a part." Ord. §§ 5703.28(c)(2), 5703.28(c)(3); see also *id.* § 5703.28(c)(1) (authorizing consideration of "increased costs of debt service due to a sale or refinancing of the rental units or the building or property of which the units are a part"). If the landlord can realize adequate return on his entire investment, his claim to additional payment for some largely unseverable segment asks too much.

It may indeed be appropriate, in evaluating a particular landlord's claim, to consider the return available not just on a single building or complex of buildings but on all of his rental properties within San Jose. This Court in *Keystone*, confronted with an argument that an entire "support estate" in property had been taken, suggested that the inquiry required under the Takings Clause might properly include all similar property interests, whether or not subject to the challenged limitation. 107 S. Ct. at 1250-51. After observing that the property owners had "acquired or retained the support estate for a great deal of land," the Court noted: "The record is devoid of any evidence on what percentage of the purchased support estates, *either in the aggregate* or with respect to any individual estate, has been affected by the Act." *Ibid.* (emphasis added); *see Baltimore & O.R.R. v. United States*, 345 U.S. 146, 148 (1953) ("So long as a railroad is not caused by such regulations to lose money on its over-all business, it is hard to think that it could successfully charge that its property was being taken for public use 'without just compensation.'"). The record on the facial challenge here is similarly devoid of any showing about what overall impact the hardship provision has on the value of property owned by particular landlords within the City of San Jose.

Appellants' conception of their property is too narrow in a second fundamental respect: it makes no allowance for, and provides no information about, other possible uses of the property. Under traditional takings analysis, however, it is not enough for a landowner simply to show that some preferred use of his land has been restricted. In *United States v. Riverside Bayview Homes, Inc.*, 106 S.Ct. 455 (1985), for example, the Court held that the need to obtain a permit for certain uses did not amount to a taking of property, stating: "[E]ven if the permit is denied, there may be other viable uses available to the owner. Only when a permit is denied and the effect of the denial is to prevent 'economically viable' use of the land in question can it be said that a taking has occurred." *Id.* at 459. Similarly, in *Andrus v. Allard*, 444 U.S. 51 (1979), the Court found that, despite regulations forbidding the sale of certain artifacts, "it is not clear that appellees will be unable to derive economic benefit from the artifacts; for example, they might exhibit the artifacts for an admissions charge." *Id.* at 66. The Court went on to declare that "loss of future profits—unaccompanied by any physical property restriction—provides a slender reed upon which to rest a takings claim." *Ibid.*

These cases recognize that the worth of any property depends upon more than its particular use at a particular time. For example, undeveloped land has value, often substantial value, not because of any current return but because of the future uses to which it can be put. It thus would make little sense to find a taking of property, based solely on the economic return for an existing use, if the property can profitably be put to use in some other manner. Whatever protection the Takings Clause may give against regulation that prevents all use of property, it should not be thought to limit regulation that, at worst, forces a change to a different, economically viable, use.[20]

In short, if appellants can receive a satisfactory return on their properties, viewed as a whole, or if they can realize value by converting them to other uses, then it is hard to see why even an unduly stringent limitation on individual rents would constitute a taking. Because the record provides no basis for resolving these questions in appellants' favor, their facial challenge must fail on these grounds alone.

B. The Tenant Hardship Provision Affects Only One Method of Obtaining Rental Increases and, in Any Event, Allows Landlords an Adequate Return

Even if the focus of the constitutional inquiry is limited to the flow of rental income from each apartment, appellants have still failed to show that the Ordinance necessarily will deny them a rent sufficient to meet constitutional standards. According to appellants, the Ordinance will have this effect because, in determining the rental increase to be allowed under Section 5703.28, the hearing officer will first set the minimum rate allowable under the Constitution and then reduce it on account of tenant hardship. This argument not only ignores the other methods of obtaining rental increases under the Ordinance but depends upon a clear misreading of the hardship provision.

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[20] It is true, of course, that the housing shortage in San Jose may not be alleviated if owners of rental properties convert them to other, more lucrative uses. But that fact bears not on whether appellants have truly lost the value of their property, but on whether the Ordinance is ultimately an effective response to the conditions prompting its enactment, a matter properly left to legislative discretion. See pages 25-27, *infra*.

Appellants appear to concede, as they must, that they are not entitled to reap the greatest possible return on their rental properties. As we have previously noted, this Court has held that the standard generally applicable in takings cases is whether the regulation "denies an owner economically viable use of his land." *Keystone*, 107 S.Ct. at 1242; *Agins v. Tiburon*, 447 U.S. at 620. Although that standard is admittedly easier to state than to apply, the Court has suggested that it involves an inquiry into such matters as whether the regulation interferes with "reasonable investment expectations" (*id.* at 262), and whether it allows the landowner "not only to profit from [the property] but also to obtain a 'reasonable return' on its investment." *Penn Central*, 438 U.S. at 136; *see also id.* at 129.

When the property at issue is conceived of as the rate charged for use or sale of a particular commodity, these principles have been set out in language pertaining to confiscation. Last Term, in reviewing rates fixed for access to privately owned utility poles, the Court stated that "so long as the rates set are not confiscatory, the Fifth Amendment does not bar their imposition." *FCC v. Florida Power Corp.*, 107 S.Ct. 1107, 1113 (1987) (citation omitted); *see also FPC v. Texaco Inc.*, 417 U.S. 380, 391-92 (1974) ("All that is protected against, in a constitutional sense, is that the rates fixed . . . be higher than a confiscatory level.") (citation omitted).[21] As a general matter, the Court has found that a rate is not confiscatory so long as it provides the owner with a "reasonable return" on his property.[22] *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575 (1942); *see also id.* at 585 ("[b]y longstanding usage in the field of rate regulation the 'lowest reasonable rate' is one which is not confiscatory in the constitutional sense").[23]

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[21] The constitutional basis of the prohibition against confiscatory rates is not wholly clear. The leading case of *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575 (1942), suggested that its roots lie in substantive due process. *See id.* at 586 ("The Constitution does not bind rate-making bodies to the service of any formula or combination of formulas. . . . Once a fair hearing has been given, proper findings made and other statutory requirements satisfied, the courts cannot intervene in the absence of a clear showing that the limits of due process have been overstepped."); *id.* at 599 (Black, Douglas and Murphy, JJ., concurring). *See also Baltimore & O.R.R. v. United States*, 345 U.S. at 148. More recently, the Court has not explicitly named the source of the constitutional protection against

As these standards indicate, it is especially difficult to show on a facial challenge that a particular rate is confiscatory. The Court has said that "whether any rate is confiscatory . . . can only be judged by 'the result reached, not the method employed.'" *FPC v. Texaco*, 417 U.S. at 392; *see also ibid.* ("Any broadside assertion that indirect regulation will be confiscatory is prema-

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confiscatory rates. *See, e.g., FPC v. Texaco*, 417 U.S. at 391-92 (referring only to "constitutional" limitations on ratemaking); *Permian Basin Area Rate Cases*, 390 U.S. 747, 768-70 (1968) (same); *FCC v. Florida Power Corp.*, 107 S.Ct. at 1113 (referring to "traditional Fifth Amendment standards").

[22] In *FPC v. Natural Gas Pipeline Co.*, the Court stated that the "just and reasonable" standard of the Natural Gas Act "coincides with that of the Constitution, and . . . the courts are without authority under the statute to set aside as too low any 'reasonable rate' adopted by the Commission which is consistent with constitutional requirements." 315 U.S. at 586.

[23] State courts reviewing rent control statutes have commonly applied some form of reasonable return standard. *See, e.g., Helmsley v. Borough of Fort Lee*, 394 A.2d 65 (N.J. 1978), *appeal dismissed*, 440 U.S. 978 (1979); *Birkenfeld v. City of Berkeley*, 550 P.2d 1001 (Cal. 1976).

A rate regulation is not confiscatory if it provides a reasonable return on *investment*. *See FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 605 (1944); *see also American Trucking Ass'ns v. United States*, 344 U.S. 298, 321-22 (1953) ("Rate-making represents an order affecting the volume of income; it is said to confiscate property when it prohibits a reasonable return on investment beyond operating and initial costs."). The San Jose Ordinance has as one of its stated purposes the assurance to landlords of a reasonable return on the *value* of their property, a rate normally higher than that required by the Constitution. *See, e.g., FPC v. Hope Natural Gas Co.*, 320 U.S. at 605.

ture."). It thus is necessary for appellants to demonstrate that landlords *cannot*, under any circumstances, obtain a constitutionally sufficient return under the Ordinance, merely because a hearing officer may consider tenant hardship in determining the reasonableness of a rental increase. Even a cursory review of the Ordinance, however, shows that this attempt must fail.

The Other Provisions

To begin with, appellants have once again taken too narrow a focus. Their attack on the hardship provision neglects the fact that landlords may well be able to receive a reasonable return solely by resort to the other methods provided by the Ordinance for obtaining an increase. Indeed, the calculations necessary to make that determination in any particular case would begin with the current rent, which, for all it appears, may itself provide a reasonable return. Initial rents in San Jose are determined by private agreements between landlords and tenants; it is entirely possible that those agreements allow for significantly more than a reasonable rate of return, given the housing shortage that gave rise to the Ordinance in the first place. See Ord. § 5701.2.

If a higher rent is desired, however, appellants have a variety of methods of getting it, several of which are unaffected by any possible tenant hardship. One method assures a landlord an annual increase of 8% of existing rent; a second allows him to pass through increased costs of certain debt service; still a third provides that he may pass through his costs of capital improvement and rehabilitation, as well as his increased costs of maintenance and operation, *and* receive an increase of 5% as well. *Id.* §§ 5703.2, 5703.28(a), 5703.28(b). None of these methods can be said, on its face, to prevent appellants from obtaining a reasonable return. For example, a rent increase that just covers operating cost increases will keep a landlord's return at exactly the dollar amount agreed upon initially with his tenant. See Baar, *Guidelines for Drafting Rent Control Laws: Lessons of a Decade*, 35

Rutgers L. Rev. 723, 740 (1983). San Jose's Ordinance permits landlords an additional increase equal to 5% of total rent. *Cf. Fisher v. City of Berkeley*, 693 P.2d 261 (Cal. 1984) (rent control including operating cost pass through), *appeal dismissed in part*, 105 S.Ct. 2683 (1985), *aff'd on other grounds*, 106 S.Ct. 1045 (1986); *see also FCC v. Florida Power Corp.*, 107 S.Ct. at 1113 ("Respondents have not contended, nor could it seriously be argued, that a rate providing for the recovery of fully allocated cost, including the actual cost of capital, is confiscatory."). Appellants have not shown that this method, or the other methods not involving tenant hardship, will necessarily lead to a confiscatory result.

The Effect of the Hardship Provision

The hardship provision thus can affect rents in San Jose only if landlords choose to bypass the methods just discussed and seek a still higher increase under Section 5703.28(c), and, even then, the provision does not carry the weight that appellants attribute to it. Despite appellants' efforts to show otherwise, nothing in Section 5703.28 requires the hearing officer to reduce rents below the amount necessary to give the landlord a reasonable rate of return. He is specifically required, in fact, to take into consideration that a purpose of the Ordinance is "to permit landlords a fair and reasonable return on the value of their property." Ord. § 5703.28. Furthermore, the permissive language of the Ordinance allows him discretion to grant the requested rent increase, notwithstanding tenant hardship, if the entire increase is necessary to give the landlord a just and reasonable return on his property: "If, on balance, the Hearing Officer determines that the proposed increase constitutes an unreasonably severe financial or economic hardship of a particular tenant, he *may* order that the excess of the increase . . . , or any portion thereof, be disallowed." *Id.* § 5703.29 (emphasis added).

The California Supreme Court, in rejecting appellants' characterization of the Ordinance, construed the hardship provision in just this manner. The Court found that

"[n]othing in the ordinance suggests or requires that, when operating under this fourth rental increase provision, proof of tenant hardship requires disallowance of any or all of a contemplated rental increase." App. A-6 n.6. Instead, the Court said, "[t]he hearing officer is required merely to 'consider' and 'balance' the tenant hardship evidence; nothing in the ordinance precludes him from granting an increase necessary to assure the landlord a fair return and thus avoid confiscatory results *despite* any resulting hardship." *Ibid.* (emphasis in original).[24]

This reading has been confirmed by the San Jose City Council itself, which passed a resolution to clarify the Ordinance in light of misinterpretations arising from this very litigation. The resolution could not be clearer. It first states that "[a] rental increase which is less than that necessary to provide a fair return on the value of property is never deemed to be [a] fair and reasonable rental increase for purposes of this Ordinance." It then addresses the purpose of Section 5703.28, declaring that it is "intended to allow the Hearing Officer to weigh and balance all factors including tenant hardship in determining what increment, if any, of rental increase greater than necessary to provide a fair return on the value of the property is fair and reasonable under the circumstances without being excessive." San Jose Resolution No. 59907, § 2 (June 16, 1987).

As a related matter, appellants are also mistaken in supposing that there is only one just and reasonable rate—to be determined by the objective factors included in Section 5703.28—possible for each apartment.[25] Similar theories about the existence of one true rate have been rejected twice by this Court, first in the *Permian Basin Area Rate Cases* and again in *Mobil Oil Corp. v. FPC*, 417 U.S. 283 (1974). *See id.* at 316 ("Mobil's argument assumes that there is only one just and reasonable rate possible for each vintage of gas, and that this rate must be based entirely on some concept of cost plus a reasonable rate of return. We rejected this argument in *Permian Basin* and we reject it again here.").[26] Those decisions establish that there is a "broad zone of reasonableness" and that any rate falling within that zone "cannot properly be attacked as confiscatory." *Permian Basin Area Rate Cases*, 390 U.S. at 770. The California Supreme Court's interpretation of the Ordinance reflects such an understanding: "[T]he ordinance grants all landlords the same constitutional fair return, and simply grants to those whose tenants can afford it an additional increase above that constitutionally required." App. at A-5 n.5.[27] Thus, even under appellants' reading of the Ordinance, a reduction of rent based upon tenant hard-

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[24] This Court has held that "[t]h[e] reading of the State's statute is within the [State] court's competency, and we must take the statute as so read and interpreted." *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 160 (1980).

[25] "The first six standards are objective . . . . Application of these six standards determines the reasonable rental value of the unit involved, which by definition cannot be excessive. The rental value of an apartment is no more dependent on the wealth or

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lack of wealth of its occupants than the value of an automobile is dependent upon the wealth or lack of wealth of its owner or driver. Accordingly, application of the seventh standard, tenant hardship, will reduce the rent below the objectively calculated reasonable rental value of the unit involved and will not and cannot operate to eliminate unreasonable or excessive rents." App. Br. at 12 (emphasis omitted).

[26] Neither has this Court accepted the proposition that only "objective" factors may be permissibly utilized to calculate a reasonable rate of return. "[R]egulation of maximum rates or prices 'may, consistently with the Constitution, limit stringently the return recovered on investment, for investors' interests provide only one of the variables in the constitutional calculus of reasonableness.'" *FCC v. Florida Power Corp.*, 107 S. Ct. at 1113 (*quoting Permian Basin Area Rate Cases*, 390 U.S. at 769); *see also FPC v. Hope Natural Gas Co.*, 320 U.S. at 603 ("[T]he fixing of 'just and reasonable' rates . . . involves a balancing of the investor and the consumer interests.").

[27] *See also FPC v. Natural Gas Pipeline Co.*, 315 U.S. at 585 ("[T]he 'lowest reasonable rate' is one which is not confiscatory in the constitutional sense.").

ship would not necessarily lead to a rate that was outside this zone of reasonableness.

In short, appellants' theory does not fit the Ordinance to which they seek to apply it. The Ordinance does not on its face confiscate appellants' property, and their claims to the contrary should be rejected.

II. THE TENANT HARDSHIP PROVISION DOES NOT IMPOSE A DISPROPORTIONATE BURDEN ON APPELLANTS OR EFFECT A PHYSICAL OCCUPATION

A. The Ordinance Does Not Require Appellants to Bear a Burden That Must Be Borne by the Public As a Whole

Mindful that a land use regulation must advance legitimate state interests,[28] appellants make the further argument that the hardship provision serves an "improper legislative purpose." App. Br. at 13. It is too late in the day, however, to suggest that assisting individual citizens on the basis of need is not a proper public purpose. *See, e.g., Bowen v. Gilliard*, 107 S. Ct. 3008 (1987); *Lukhard v. Reed*, 107 S. Ct. 1807 (1987); *Goldberg v. Kelly*, 397 U.S. 254 (1970). Nor is there any question that the City Council meant to advance that interest or that the Ordinance does in fact do so. The preamble to the Ordinance settles the first point[29]; appellants have conceded the second.[30]

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[28] *See Keystone*, 107 S. Ct. at 1242 ("We have held that land use regulation can effect a taking if it 'does not substantially advance legitimate state interests, . . . or denies an owner economically viable use of his land.' *Agins v. Tiburon*, 447 U.S. [at 260] (citations omitted)."). *See also Penn Central*, 438 U.S. at 127 ("It is, of course, implicit in *Goldblatt* [*v. Hempstead*, 369 U.S. 590 (1962),] that a use restriction on real property may constitute a 'taking' if not reasonably necessary to the effectuation of a substantial public purpose."); *Nectow v. Cambridge*, 277 U.S. 183, 188 (1928).

[29] The Ordinance sets out three specific needs to be met by its provisions: to eliminate excessive and unreasonable rents, to assure landlords a fair and reasonable return on investment, and to alleviate undue hardship upon individual tenants. Ord. § 5701.2.

[30] See App. Br. at 13 ("the tenant hardship provisions . . . do serve the stated legislative purpose of alleviating the financial

It appears, therefore, that appellants' real objection is to the *means* used by the Ordinance, not to the purpose behind it. In particular, appellants frequently assert that they are being required to bear a burden properly borne by all landlords or even by all citizens of San Jose. Although appellants principally rely on a state law equal protection decision for this argument,[31] several *amici curiae* make the same attack under the Takings Clause,[32] invoking the oft-repeated observation that the Clause was "designed to bar government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Armstrong v. United States*, 364 U.S. 40, 49 (1960). *See also Pennsylvania Coal v. Mahon*, 260 U.S. at 415 (regulation should "secur[e] an average reciprocity of advantage").

As appellants appear to recognize (App. Br. at 23-26), however, the idea that one group has been unfairly burdened is an end product of takings analysis; it is not the analysis itself. As this Court said in *Agins v. Tiburon*, 447 U.S. at 260, the "determination that governmental

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and economic hardship of individual tenants"). *Cf. Nollan v. California Coastal Comm'n*, 107 S.Ct. 3141 (1987) (condition on property unrelated to legitimate public purpose).

[31] Appellants' reliance in this context upon *Department of Mental Hygiene v. Kirchner*, 388 P.2d 720 (Cal. 1964) (see App. Br. at 19-20; J.S. at 13-14), is misplaced. *Kirchner* is a California Supreme Court decision based on an independent state law ground. *See Department of Mental Hygiene v. Kirchner*, 380 U.S. 194 (1965) (vacating and remanding); *Department of Mental Hygiene v. Kirchner*, 400 P.2d 321 (Cal. 1965) (finding the decision to rest upon independent state law grounds). The California Supreme Court declined to extend *Kirchner* to the facts of this case.

[32] See, *e.g.*, Brief *Amicus Curiae* of the Competitive Enterprise Institute at 3-4; Brief *Amicus Curiae* of the National Multi Housing Council at 22-23; Brief *Amicus Curiae* of the National Association of Realtors at 14-15; Brief *Amicus Curiae* of Rent Stabilization Association of New York City, Inc., *et al.*, at 11-12 (undifferentiated references to the Due Process, Equal Protection, and Takings Clauses).

action constitutes a taking is, in essence, a determination that the public at large, rather than a single owner, must bear the burden of an exercise of state power in the public interest." The necessary inquiry does not, and should not, proceed along the lines of comparing the burdened group to some other group but through ad hoc factual inquiries evaluating the character of the governmental action and the economic impact of the regulation. *See Kaiser Aetna*, 444 U.S. at 175. The mere narrowness of the burdened class—in the absence of diminution in value sufficient to support an independent finding that property has been "taken"—is not enough to establish a violation of the Takings Clause.

It seems to us, in fact, that an attack mounted on the narrowness of a burdened class is largely indistinguishable from the garden-variety attacks made upon economic regulation under the Due Process or Equal Protection Clauses. All share a common theme: that the legislature should pursue the public welfare some other way or, perhaps, not at all. In this case, for example, appellants and their *amici* suggest that aid to poorer tenants could be provided through some sort of general tax and a direct subsidy by the City.[33] More ambitiously, they contend that rent control is in fact counterproductive and that, contrary to the City's view, the market will best provide adequate housing at reasonable cost.[34]

These sorts of objections are commonly and rightly rejected when made in the form of due process and equal protection challenges. It is a truism that this Court does not sit to pass upon the wisdom of economic legislation. *See, e.g., Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 466 (1981); *Day-Brite Lighting, Inc. v. Mis-*

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[33] See, *e.g.*, App. Br. at 21; Brief *Amicus Curiae* of the Rent Stabilization Association, *et al.*, at 14; Brief *Amicus Curiae* of the National Association of Realtors at 21.

[34] See, *e.g.*, Brief *Amicus Curiae* of the Competitive Enterprise Institute at 5-14; Brief *Amicus Curiae* of the National Multi Housing Council at 6-15.

souri, 342 U.S. 421, 423 (1952). Statutes that impose different obligations on different classes are upheld unless the obligations are "so disparate, relative to the difference in classification, as to be wholly arbitrary." *Walters v. City of St. Louis*, 347 U.S. 231, 237 (1954). As a general rule, the courts must "defe[r] to legislative determinations as to the desirability of particular statutory discriminations." *City of New Orleans v. Dukes*, 427 U.S. 297, 303 (1976).[35]

There is no good reason why the Takings Clause should require a less deferential review of general economic legislation. Indeed, this Court has suggested that, having upheld regulatory provisions against attack under the Due Process Clause, "it would be surprising indeed to discover now that in both cases Congress unconstitutionally had taken the assets of the employers there involved." *Connolly v. Pension Benefit Guaranty Corp.*, 106 S. Ct. 1018, 1025 (1986); *see Pension Benefit Guaranty Corp. v. R. A. Gray & Co.*, 467 U.S. 717 (1984) (earlier decision under Due Process Clause). Although it will frequently be the case that some property will be affected by regulation in ways that other property is not, the Takings Clause does not require either the broadest or narrowest regulation possible to suit the legislative purpose. "That a land use regulation may be somewhat overinclusive or underinclusive is, of course, no justification for rejecting it." *Keystone*, 107 S. Ct. at 1243 n.16; *see Euclid v. Ambler Realty*, 272 U.S. at 388-89.

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[35] Applying these principles the California Supreme Court properly rejected appellants' arguments on equal protection grounds. The burdened class (landlords with hardship tenants) is in no way suspect; neither does the provision affect the exercise of a fundamental right. The Ordinance is clearly rationally related to a legitimate governmental purpose—easing the burden of receiving adequate housing for those tenants who are less able to bear the costs. *Cf. Exxon v. Eagerton*, 462 U.S. 176, 195 (1983); *McGowan v. Maryland*, 366 U.S. 420, 426 (1961) (classifications will be held rational if any conceivable basis for them can be imagined). We believe that this same analysis is sufficient to dispose of appellants' substantive due process challenge as well.

In any event, appellants have no legitimate grounds for protesting their share of the burden. "The Takings Clause has never been read to require the States or the courts to calculate whether a specific individual has suffered burdens under this generic rule in excess of the benefits received." *Keystone*, 107 S. Ct. at 1245 n.21.[36] Although application of the hardship provision may mean that one person has slightly less and another has slightly more, this Court has observed that "Congress routinely creates burdens for some that directly benefit others. For example, Congress may set minimum wages, control prices, or create causes of actions that did not previously exist." *Connolly v. Pension Benefit Guaranty Corp.*, 106 S.Ct. at 1025.[37] Such activities, concededly, may interfere with the free market, but that is permissible: "the function of government may often be to tamper with free markets, correcting their failures and aiding their victims." *Fisher v. City of Berkeley*, 106 S.Ct. 1045, 1048 (1986).

Nor does the class of burdened San Jose landlords seem unconscionably narrow. While appellants have not introduced any evidence tending to demonstrate the number of landlords actually affected, the California Supreme Court assumed that "all families whose incomes are less than 80 percent of the median family income in the area" will be deemed hardship tenants under the criteria set out in the Ordinance. See App. at A-5; see also *id.* at A-14 (dissenting opinion). Looked at as a mere numbers game, therefore, the burdened group of landlords seems no smaller than other groups subject to regulations upheld by this Court. For example, in *Penn Central*, the Court upheld a New York landmark regulation that imposed affirmative duties for upkeep and severely restricted the development of 400 buildings and structures—deemed official landmarks—out of the over 1,000,000 buildings in the City of New York. *See* 438 U.S. at 138 (Rehnquist, J., dissenting). The Court rejected the contention that these property owners were, out of all the property owners in Manhattan, "solely burdened and unbenefitted," deferring to the legislative judgment that the Landmarks Law benefitted all New York citizens and structures "both economically and by improving the quality of life in the city as a whole." *Id.* at 134. Indeed, this Court has upheld regulation that burdened as few as two individual landowners. *See, e.g., Hadacheck v. Sebastian*, 239 U.S. at 406.

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[36] It is not clear how the benefits and burdens might be weighed in this case. For example, it is certainly conceivable that appellants' property has greater value than it otherwise would have because, under the zoning laws, they have been permitted to operate rental units and others have not. It would hardly seem inequitable then for the City to decide that, given appellants' unusual capacity to exploit a housing shortage, they should share some of that advantage with the tenants least able to bear the consequences. The San Jose City Council is uniquely situated to make that judgment.

[37] The Court went on to conclude that "[g]iven the propriety of the governmental power to regulate, it cannot be said that the Taking Clause is violated whenever legislation requires one person to use his or her assets for the benefit of another." *Connolly*, 106 S.Ct. at 1025.

The plain fact is that appellants' property has not been taken. Although they obviously would prefer some other legislative program—one that allowed them the greatest possible profit from their property—the Takings Clause does not allow them to impose that preference on the City of San Jose.

B. The Hardship Provision Does Not Amount to a Physical Occupation of Appellants' Property

Because a " 'taking' may more readily be found when the interference with property can be characterized as a physical invasion by government" (*Penn Central*, 438 U.S. at 124; *Keystone*, 107 S. Ct. at 1244 n.18), litigants are naturally tempted so to characterize their claims.[38] Here, relying largely on *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982), appellants suggest that their own complaint is analogous to one for a physical taking "[b]ecause the subject ordinance requires landlords to continue renting to existing tenants . . . ." App. Br. at 30.

Appellants' argument is easily dispensed with. In its most recent case dealing with rental of property, this Court distinguished *Loretto* on the ground that the landlord there had not consented to the initial occupation of her property on any terms. *See FCC v. Florida Power*, 107 S.Ct. at 1112. "The line which separates these cases from *Loretto* is the unambiguous distinction between a commercial lessee and an interloper with a governmental license." *Ibid.* Like the Pole Attachments Act upheld in *Florida Power*, the San Jose Ordinance does not give tenants the right to occupy the landowner's property: it leaves to landlords the decision whether to rent and on what initial terms.[39]

Although *Florida Power* did leave open the question what the application of *Loretto* "would be if the FCC in a future case required utilities, over objection, to enter into, renew or refrain from terminating pole attachment agreements" (107 S. Ct. at 1112 n.6), this case does not pose a similar question. The San Jose Ordinance does not prevent the routine eviction of tenants from rent-controlled units, as many other rent control ordinances do.[40]

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[38] This Court has given particular significance in the taking inquiry to the "character of the government action." *Keystone*, 107 S. Ct. at 1247, *citing Kaiser Aetna*, 444 U.S. at 175. If a regulation effects a permanent physical occupation, it is *per se* a taking for which compensation must be paid. *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982).

[39] *Cf. FCC v. Florida Power*, 107 S.Ct. at 1112 ("[W]hile the statute we considered in *Loretto* specifically *required* landlords to permit permanent occupation of their property by cable companies, nothing in the Pole Attachments Act as interpreted by the FCC in these cases gives cable companies any right to occupy space on utility poles, or prohibits utility companies from refusing to enter into attachment agreements with cable operators.") (emphasis in original).

[40] This Court has dismissed a challenge under *Loretto* to just such a provision. *See Fresh Pond Shopping Center, Inc. v. Cal-*

Rather, it deems such evictions "non-voluntary vacancies," the effect of which is to leave the units subject to rent control for any new residential tenant. The only evictions prevented by the Ordinance are retaliatory evictions against tenants for exercising their rights under the Ordinance and evictions intended to evade the purposes of the Ordinance. Ord. § 5706.1. These restrictions, which are clearly necessary to assure the effectiveness of the Ordinance, do not effect the sort of permanent physical occupation envisioned by *Loretto.*

CONCLUSION

For the foregoing reasons, the judgment of the Supreme Court of California should be affirmed.

Respectfully submitted,

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lahan, 464 U.S. 875 (1983), *dismissing appeal from Fresh Pond Shopping Center, Inc. v. Rent Control Board,* 446 N.E. 2d 1060 (Mass. 1983). In that case, the anti-eviction provision of the Cambridge city ordinance prevented eviction except for demolition of the building or occupation by the owner. The owner was denied a permit under the ordinance to demolish a six-unit building in which only one unit was occupied. In addition, the landlord, as a corporate entity, was unable to comply with the ordinance's requirement that it take possession of the property in order to evict the remaining tenant. *See* 464 U.S. at 875-77 (Rehnquist, J., dissenting from dismissal of appeal).

AMICUS CURIAE

BRIEF

(19)

No. 86-753

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

◆

RICHARD PENNELL and
TRI-COUNTY APARTMENT HOUSE OWNERS ASSOCIATION,
Appellants,

—vs.—

CITY OF SAN JOSE and
CITY COUNCIL OF THE CITY OF SAN JOSE,
Appellees.

ON APPEAL FROM THE SUPREME COURT OF CALIFORNIA

AMICUS CURIAE BRIEF FOR THE AMERICAN CIVIL LIBERTIES UNION AND THE AMERICAN CIVIL LIBERTIES UNION OF SOUTHERN CALIFORNIA IN SUPPORT OF APPELLEES

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QUESTION PRESENTED

Whether a rent control ordinance that has been authoritatively construed by the state's highest court to guarantee landlords a reasonable return is nevertheless unconstitutional merely because its balancing test for even higher rents is tailored to weigh tenant hardship as one of several relevant factors.

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INTEREST OF AMICI[1]

The American Civil Liberties Union (ACLU) is a nationwide, non-partisan organization of over 250,000 members. The ACLU of Southern California is one of its affiliates.

Both the ACLU and its affiliates are dedicated to protecting the fundamental rights guaranteed by the United States Constitution. Preservation of those rights inevitably depends on their proper definition. In this case, we agree with the California Supreme Court that the San Jose rent control ordinance is consistent with constitutional principles. Because the ACLU also recognizes a close connection between civil liberties and the problems of poverty that the challenged ordinance seeks to alleviate, we submit this brief in support of the appellees and urge affirmance of the judgment below.

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[1] The parties have consented to the filing of this brief, as indicated by their letters of consent filed with the Clerk of the Court.

STATEMENT OF THE CASE

Amici adopt the comprehensive Statement of the Case contained in Appellees' Brief. Certain relevant facts are highlighted in the Introduction that follows.

INTRODUCTION

Appellants challenge the facial validity of a rent control ordinance enacted by the City of San Jose.[2] They do not contend that the ordinance has, in operation, actually deprived them of a reasonable return on their rental property.

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[2] The San Jose Rental Dispute Mediation and Arbitration Ordinance, San Jose, Cal., Municipal Ordinance 19,696 (July 10, 1979) (codified at San Jose Municipal Code, art. V, ch. 7). All statutory references are to the ordinance as set forth in Appendix E of Appellants' Jurisdictional Statement.

The ordinance was adopted by San Jose in response to local housing problems. In its "Declaration of Policy and Purposes" the ordinance states that it is "designed to alleviate some of the more immediate needs created by San Jose's housing situation," including "the prevention of excessive and unreasonable rent increases, the alleviation of undue hardship upon individual tenants, and the assurance to landlords of a fair and reasonable return on the value of their property." Section 5701.2.

In furtherance of these purposes, the ordinance provides for annual rent increases structured to assure each landlord "a fair and reasonable return on the value of their property." Every landlord is automatically entitled to increase his rent by at least eight percent per unit

per year.[3] Section 5703.2. A landlord who desires additional rent may seek (i) a base raise of five percent plus an additional increase to cover specified costs,[4] Section 5703.28(a); (ii) an increase based on the landlord's rising costs of debt service, Section 5703.28(b); or (iii) any increase deemed "reasonable under the circumstances" by a rent control hearing officer, Section 5703.28(c).

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[3] This increase is available to the landlord without any need for supporting documentation. Furthermore, the ordinance entitles landlords who have refrained from rent increases for a year or more to a 15% or 21% increase, depending on the interval since the previous rent rise. Section 5703.5.

[4] The specified costs that may be passed on to the tenant under this formula include expenses for capital improvements, rehabilitation of the property, and maintenance and operation. Neither appellants nor any of the amici supporting them suggest any additional factor that could or should be considered by San Jose in calculating a fair return. That deficiency underscores the inherently speculative nature of appellants' claim.

Under the final increase formula at issue in this case, the determination of "reasonableness" is based on seven prescribed factors: (1) financing costs, (2) rental history, (3) physical condition of the rental unit, (4) its service history, (5) other financial information that the landlord is willing to provide, (6) existing market rents for comparable units, and (7) "hardship to [the] tenant." Id.

These factors are weighed together by the hearing officer in calculating a fair rent for each unit in the building. Contrary to appellants' suggestion, the hearing officer does not first arrive at a fair rent and then reduce it in cases of tenant hardship. Rather, tenant hardship is considered as one factor among many in determining what rent is fair. And regardless of tenant hardship, the approved rent increase may not fall below

the eight percent floor guaranteed by the ordinance.[5]

The California Supreme Court upheld this statutory framework against facial challenges under the just compensation, due process, and equal protection clauses of the fifth and fourteenth amendments. Pennell v. City of San Jose, 42 Cal. 3d 365 (1986). The court construed the ordinance to provide that "in all cases hearing officers must allow landlords a rent increase that yields a fair and reasonable return." Id. at 369. Moreover, "nothing in the ordinance precludes [the hearing officer] from granting an increase necessary to assure the landlord a fair return and thus avoid confiscatory results despite any resulting hardship" to tenants. Id. at 370 n.6 (emphasis in original). Accordingly, the court held, "the ordinance grants all landlords the same constitutional fair return, and simply grants to those whose tenants can afford it an additional increase above that constitutionally required." Id. at 369 n.5.

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[5] Moreover, the hardship provision does not apply to the costs of debt service incurred in good faith before the effective date of the ordinance. Section 5703.31(a).

As interpreted by the California Supreme Court, therefore, the tenant hardship provision of the San Jose ordinance is effectively overridden if the proposed rents would not provide the property owner with a reasonable return on his or her property. Should a specific application of the ordinance deprive a specific landlord of a reasonable return, then the California courts and this Court remain available to hear a challenge to the ordinance as applied.

SUMMARY OF ARGUMENT

This case concerns the power of a municipality to adopt local rent control measures to deal with local housing problems. Specifically, the City of San Jose has adopted a carefully calibrated scheme of economic regulation that promotes the important public purpose of securing affordable housing while guaranteeing affected landlords a reasonable return from their rental units.

Under this Court's prior decisions, such land use regulation is constitutionally valid so long as it substantially advances a legitimate state interest and permits the landowner an economically viable use of his land. The San Jose ordinance fulfills both these requirements. Its stated purpose of providing affordable housing fits comfortably within the police power. The fact the the ordinance permits consideration of tenant hardship in calculating "reasonable" rents does not defeat its public purpose. This is especially true because the tenant hardship provision, to which appellants so strenuously object, does not even apply unless the landlord has first been guaranteed a reasonable return. That interpretation of the ordinance by the California Supreme Court is binding on this Court, and defeats any claim that the ordinance represents a taking without just compensation.

Similarly, appellants' claim that the ordinance imposes a discriminatory tax on landlords in order to subsidize the poor fundamentally misconceives the nature of the rent control ordinance. The ordinance does not deprive landlords of any earned income, vested property right, or statutory entitlement. At most, it reduces anticipated profits that are

properly the subject of regulation. Furthermore, the inescapable reality that some landlords may be affected more than others by operation of the ordinance is not constitutionally decisive when dealing with economic regulation.

ARGUMENT

I. THE SAN JOSE ORDINANCE GUARANTEES LANDLORDS A FAIR RETURN AND THUS DOES NOT VIOLATE THE DUE PROCESS OR THE JUST COMPENSATION CLAUSES

A. The California Supreme Court's Construction Of The Ordinance To Guarantee A Reasonable Return For Landlords Is Binding On This Court.

The California Supreme Court has authoritatively held that the San Jose ordinance is a reasonable exercise of the police power that guarantees landlords a fair return on their investment. Any ambiguity in the language of the ordinance has thus been resolved in favor of its constitutionality.

Appellants misconstrue the ordinance in order to create a conflict with the Constitution, claiming that the tenant hardship provisions "deny landlords a just and reasonable return on their property."

Appellants' Brief at 11. Appellants' reading, however, cannot stand once the California Supreme Court has rejected it. Indeed, the California Supreme Court has stated that: "A rent control ordinance need not even expressly assure a fair return at all; if there is no such provision, one will be implied." Cotati Alliance for Better Housing v. City of Cotati, 148 Cal. App. 3d 280, 290, 195 Cal. Rptr. 825, 831 (1983).[6]

On such a question of state law, the interpretation by the California Supreme Court is final and cannot be rejected by this Court or any other federal court. E.g., Estate of Thornton v. Caldor, Inc., 472 U.S. 703, 709 n.8 (1985); Mullaney v. Wilbur, 421 U.S. 684, 691 (1975) ("state courts are the ultimate expositors of state law"); Murdock v. Mayor and Aldermen of Memphis, 87 U.S. (20 Wall.) 590 (1875).

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[6] In the context of a rent control ordinance that did not expressly guarantee that landlords would receive a reasonable return, the New Jersey Supreme Court has similarly held that "such a provision must be impliedly deemed to have been incorporated in it" and that every such ordinance will be read to permit landlords to apply "for relief on the ground that the regulation entitles the owner to a just and reasonable rate of return." Property Owners Ass'n v. Township of North Bergen, 74 N.J. 327, 335-36, 378 A.2d 25, 29 (1977).

B. The San Jose Ordinance Is Not A Taking Under The Constitution.

This Court has long granted broad deference to land use regulations adopted by local governments in response to local conditions. Village of Belle Terre v. Boraas, 416 U.S. 1 (1974); Village of Euclid v. Ambler Realty Co., 272 U.S. 365 (1926). Correspondingly, this Court has consistently recognized that land use regulations do not represent an unconstitutional taking if two conditions are satisfied. First, the regulation must substantially advance a legitimate state

interest. Second, it must leave the property owner with an economically viable use of his land. Nollan v. California Coastal Comm'n, 55 U.S.L.W. 5145, 5147 (June 26, 1987); Agis v. Tiburon, 477 U.S. 255, 260 (1980); Penn Central Transp. Co. v. City of New York, 438 U.S. 104, 127 (1978). The San Jose ordinance, as authoritatively construed by the California Supreme court, easily satisfies both these requirements.[7]

1. The San Jose Ordinance Is Substantially Related To A Legitimate State Purpose.

The challenged ordinance was adopted

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[7] Nollan stressed that "a broad range of governmental purposes and regulations satisfies these requirements," which have been "long recognized." Nollan, 55 U.S.L.W. at 5147. Thus, notwithstanding the debate between the majority and dissent over whether the standard for takings challenges is different from those for due process or equal protection claims, see id. at 5147 n.3, discussed infra note 14, Nollan must be read to maintain the traditional deference extended to local regulation of property.

by the San Jose City Council in response to local housing needs. See supra p. 4. Clearly, the desire to provide affordable housing for the city's residents represents a legitimate exercise of the police power. Appellants do not argue otherwise. Rather, appellants contend that the inclusion of a tenant hardship provision in the San Jose ordinance somehow denudes it of its public purpose. That argument is without merit.

Fairly understood, the tenant hardship provision is merely a less restrictive means of providing affordable housing for the residents of San Jose than the single rent ceiling favored by many municipalities. Cf. Posadas de Puerto Rico Assocs. v. Tourism Co., 478 U.S. ___, 92 L. Ed. 2d 266, 283-84 (1986). As this Court recently observed in the context of a land use regulation: "[A] permit

condition that serves the same legitimate police-power purpose as a refusal to issue the permit should not be found to be a taking if the refusal to issue the permit would not constitute a taking." Nollan, 55 U.S.L.W. at 5147.

Appellants suggest that the relief of tenant hardship is not a public purpose because it promotes what appellants describe as a private interest. However, "[i]t is not essential that the entire community, nor even a considerable portion, ... directly enjoy or participate in any improvement in order [for it] to constitute a public use." Hawaii Housing Auth. v. Midkiff, 467 U.S. 229, 244 (1984); accord Block v. Hirsh, 256 U.S. 135, 155 (1921) ("the use by the public generally of each specific thing affected cannot be made the test of public interest"). The San Jose City Council has found that its rent control ordinance is necessary to "protect the health, safety and welfare of the citizens of San Jose." Section 54701.2. Its judgment is entitled to respect from this Court.

"[T]he legislature, not the judiciary, is the main guardian of the public needs to be served by social legislation," and "when the legislature has spoken, the public interest has been declared in terms well-nigh conclusive." Midkiff, 467 U.S. at 239.

Accordingly, "the Court has made clear that it will not substitute its judgment for a legislature's judgment as to what constitutes a public use" unless the basis for the judgment is palpably unreasonable. Id. at 241. "[A]ny departure from this judicial restraint would result in courts deciding on what is and is not a governmental function." Id. at

240.

Appellants further contend that tenant hardship may not be considered in determining a "reasonable" rent because it is unrelated to the rental value of the apartment, Appellants' Brief at 12, or "the burdens and benefits created by the projects involved," id. at 16. Yet the same may be said of the financial needs of tenants as a class, which appellants concede are essential to determining "reasonable" rents under traditional rent control ordinances. Id. at 12.[8]

This Court should maintain the broad deference traditionally extended to economic regulation,[9] through which state and local legislators decide where the public interest lies. At a minimum, the San Jose City Council is constitutionally free to decide that aiding the poor, who most need relief, is in the public interest. Case-by-case application of a general rule designed to serve that objective does not diminish its public purpose.

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[8] The settled and accepted relationship between rent control and the state's legitimate interest in maintaining an affordable housing market for its residents distinguishes this case from Nollan, 55 U.S.L.W. 5145, where the Court found no substantial nexus between the challenged permit condition and the asserted governmental purpose.

2. The San Jose Ordinance Guarantees Landlords A Reasonable Return Consistent With Constitutional Guarantees.

This Court has defined an unconstitutional taking as one that deprives property owners of an economically viable use of their property. Nollan, 55 U.S.L.W. at 5147. Here, San Jose has met that obligation by guaranteeing landlords

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[9] See, e.g., Ferguson v. Skrupa, 372 U.S. 726, 730-32 (1963); Williamson v. Lee Optical, Inc., 348 U.S. 483 (1955); United States v. Carolene Products Co., 304 U.S. 144, 152, 154 (1938).

subject to its ordinance a reasonable return from each and every rental unit. As a matter of constitutional law, appellants have no right to demand anything more.

Like all rent control statutes, the San Jose ordinance undoubtedly restricts "the most profitable use of [the owner's] property." Andrus v. Allard, 444 U.S. 51, 66 (1979). But for constitutional purposes, "that is not dispositive." Id. As this Court has repeatedly emphasized in analogous contexts, a "diminution in property value, standing alone," does not establish a taking. Penn Central, 438 U.S. at 131. Conversely, this Court has recognized that "government may execute laws or programs that adversely affect recognized economic values," id. at 124, without offending the Constitution.

Applying that well-settled principle,

this Court and lower courts have consistently upheld rent control ordinances against constitutional challenges if they are reasonably calculated to eliminate excessive rents and provide landlords a just and reasonable return. *See*, *e.g.*, *Bowles v. Willingham*, 321 U.S. 503 (1944); *Block v. Hirsh*, 256 U.S. 135 (1921); *Eisen v. Eastman*, 421 F.2d 560, 567 (2d Cir. 1969), *cert. denied*, 400 U.S. 841 (1970); *Fisher v. City of Berkeley*, 37 Cal. 3d 644, 209 Cal. Rptr. 682, 693 P.2d 291 (1984), *aff'd*, 471 U.S. 1124 (1985) (mem.) (dismissing constitutional challenge for want of a substantial federal question) *and* 475 U.S. 260 (1986) (upholding rent control against antitrust challenge).

Under this standard, the San Jose ordinance does not violate substantive due process, nor does it effect a taking requiring just compensation, because the tenant hardship provision is only triggered after the landlord has first received a fair return from each rental unit.[10] Indeed, this Court has upheld price controls even if they "limit stringently the return recovered on investment, for investors' interests provide only one of the variables in the constitutional calculus of reasonableness." Permian Basin Area Rate Cases, 390 U.S. 747, 769 (1968).

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[10] Appellants contend that "the subject ordinance requires landlords to continue renting to their existing tenants," and that "the case is analogous to the physical taking and occupation cases where a taking will be found regardless of diminution in the value of the property subject to regulation." Appellants' Brief at 30. In support of this claim, appellants cite Section 5706.1, entitled "Retaliatory Eviction," which bars eviction if the landlord's dominant motive is (a) "retaliation against the tenant for exercising his or her rights" under the ordinance, or (b) "to evade the purposes" of the ordinance. Appellants assume that subsection (b) would prevent a landlord who is dissatisfied with the prescribed rent from withdrawing the property from the housing market. It is sufficient to note at this point that until subsection (b) is so construed, this alleged constitutional infirmity is speculative and not properly before this Court. But even if the ordinance is so applied, this Court has stated that even a physical occupation must be evaluated in light of the state's "broad power to regulate housing conditions in general and the landlord-tenant relationship in particular without paying compensation for all economic injuries that such regulation entails." *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 440 (1982).

Appellants argue that the ordinance cannot be read to provide a just and reasonable return despite the interpretation by the California Supreme Court because "the tenant hardship factors necessarily result in depriving landlords of what the hearing officer would otherwise objectively calculate as a reasonable return." Appellants' Brief at 10. But this non-sequitur mistakenly assumes that there is only one "reasonable" rate of return. For the purposes of constitutional law, there is a range of "reasonable" returns bound by a constitutionally required minimum, below which rent control becomes confiscatory. Within this range,

the City of San Jose is free to deem a variety of rents to be "reasonable" or "excessive" as a matter of local law and to regulate those rents accordingly.[11]

As this Court has noted with regard to rate regulation, "the 'lowest reasonable rate' is one which is not confiscatory in the constitutional sense"; accordingly "there is a zone of reasonableness within which the [regulator] is free to fix a rate varying in amount and higher than a confiscatory rate" and "to decrease any rate which is not the 'lowest reasonable rate.'" Federal Power Comm'n v. Natural Gas Pipeline Co. of America, 315 U.S. 575, 585-86 (1942).

San Jose has done nothing more in

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[11] Cf. Anderson v. Creighton, 55 U.S.L.W. 5092, 5094 (June 25, 1987) (holding that an officer may act "reasonably" for purposes of qualified immunity while conducting a search deemed "unreasonable" under the fourth amendment).

this case. Its definition of a reasonable return is based on a formula that can generate rates at or above the constitutionally required minimum. Having assured each landlord a reasonable and non-confiscatory rent, San Jose has satisfied its constitutional obligation. Beyond that, "[t]he Constitution does not bind rate-making bodies to the service of any single formula." Natural Gas Pipeline, 315 U.S. at 586.

The California Supreme Court properly distinguished cases cited by appellants that struck down as facially invalid rent control formulas that could not avoid confiscatory results when applied to some parties. Pennell, 42 Cal. 3d at 372 n.9, distinguishing Helmsley v. Borough of Fort Lee, 78 N.J. 200, 394 A.2d 65 (1978) and Property Owners Ass'n v. Township of North Bergen, 74 N.J. 327, 378 A.2d 25 (1977).

By contrast, the San Jose ordinance provides for a flexible balancing approach that avoids confiscatory results and that cannot, therefore, be challenged on its face, id. at 370 n.6, because it is susceptible to constitutional application, especially as construed by the California Supreme Court. Cf. Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc., 445 U.S. 489, 497 (1982).

II. THE CONSTITUTION DOES NOT COMPEL A MUNICIPALITY TO ADOPT A HOUSING SUBSIDY PROGRAM IN LIEU OF A RENT CONTROL ORDINANCE THAT MAY HAVE A DISPARATE IMPACT ON CERTAIN LANDLORDS

A. The San Jose Ordinance, Like All Rent Control, Adjusts Only Future Gains And Is Not A Discriminatory Tax Or Subsidy.

In addition to their claim of an unconstitutional taking, appellants assert that tenant hardship is a public burden that must be borne by the public at large. Consequently, appellants contend, the San Jose ordinance represents a discriminatory tax unfairly imposed on landlords alone. Appellants' conclusion is wrong because their premise is flawed.

The San Jose ordinance is not a tax for the simple reason that it does not deprive landlords of any earned income, vested property right, or statutory entitlement. It merely regulates in advance the return they may receive from rental units in San Jose.

As this Court has repeatedly emphasized, property interests "are not created by the Constitution. Rather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law ...." Board of Regents of State Colleges v. Roth, 408 U.S. 564, 577

(1972). Here, the State of California and its localities have validly exercised their "residual authority ... to define 'property' in the first instance." Pruneyard Shopping Center v. Robins, 447 U.S. 74, 84 (1980).

Repeating their previous error, appellants argue that the inclusion of tenant hardship in the calculus of reasonable rents frustrates "reasonable investment-backed expectations." Appellants' Brief at 26. As this Court has noted, however, "the interest in anticipated gains has traditionally been viewed as less compelling than other property-related interests." Andrus v. Allard, 444 U.S. 51, 66 (1979). Thus, "loss of future profits -- unaccompanied by any physical property restriction -- provides a slender reed upon which to rest a takings claim." Id.; accord Webb's

Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 161 (1980) ("a mere unilateral expectation or an abstract need is not a property interest entitled to protection").[12]

For example, in Bowen v. Gilliard, 55 U.S.L.W. 5079 (June 25, 1987), this Court recently rejected a constitutional challenge to an AFDC requirement that child support payments from an absent parent be assigned to the state and charged to the entire family. While recognizing that the regulation reduced the family's welfare benefits, this Court held that the family had "no protected property rights to continued benefits at the same level." Id. at 5083. Here, the landlord has a substantially less compelling claim because there is no reduction in actual benefits, only an adjustment of the increased future rent that may be received under the San Jose ordinance.

Even more to the point, this Court noted in Gilliard that "the prospective right to support payments, and the child's expectations with respect to the use of such funds, are clearly subject to modification by law." Id. at 5084. In particular, "one of the chief criteria in assessing a child-support obligation is the noncustodial parent's ability to make payments ... and an adverse change in that parent's ability may, of course, require a modification ...." Id. That is precisely the judgment that San Jose has made with regard to rent control. If the regulatory scheme in Gilliard did not represent a discriminatory tax selectively imposed on one child for the benefit of another, then the ordinance in this case does not represent a discriminatory tax imposed on landlords for the benefit of tenants.

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[12] Appellants' discriminatory tax claim and taking claim are inevitably intertwined because both rest on the assertion that landlords have a right, protected by the Constitution, to some "objectively" set rent without regard to tenant hardship.

Appellants' reliance on a line of California cases holding that family members can not be asked to reimburse the state for care of the mentally ill in public institutions is clearly misplaced. See In re Jerald C., 36 Cal. 3d 1, 6, 201 Cal. Rptr. 342, 678 P.2d 917 (1984); Department of Mental Hygiene v. Kirchner, 60 Cal. 2d 716, 36 Cal. Rptr. 488, 388 P.2d 720 (1964); Department of Mental Hygiene v. Hawley, 59 Cal. 2d 247, 28 Cal. Rptr. 718, 379 P.2d 22 (1963). The theory of those cases is that the coerced payments sought by the state "select ... one class of persons for a species of taxation" when "no rational basis supports such classification." Kirchner, 60 Cal.

2d at 722, 36 Cal. Rptr. at 492, 388 P.2d at 724. Here, landlords are not being asked to "pay" anything except in the sense that they are denied future earnings they hoped to achieve.

Likewise, Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155 (1980), also cited by appellants, is readily distinguishable. There, the Court found no "police power justification" to support the state's claim to interest gained on a private interpleader account. Id. at 163. By contrast, San Jose's ordinance is designed to allocate scarce housing among local residents consistent with the landlords' right to a fair return on his or her property. It therefore clearly qualifies as a "public program adjusting the benefits and burdens of economic life to promote the common good." Penn Central, 438 U.S. at 124.[13]

As the California Supreme Court noted, the alternative of financing a subsidy from general tax revenues "has never been considered a bar to the validity of such legislation." Pennell, 42 Cal. 3d at 372. Nor is the possibility that San Jose's tenant hardship relief could be financed more broadly any reason to hold that ordinance unconstitutional. "[W]hether a broader cost-spreading scheme would have been wiser or more practical under the circumstances is not a question of constitutional dimension." Usery v. Turner Elkhorn Mining Co., 428 U.S. 1, 19 (1976) (upholding a "black lung" liability scheme against a due process challenge).

B. Any Disparate Impact Of The Tenant Hardship Provision Is Incidental To A Regulation Rationally Related To The Goal Of Affordable Housing.

Appellants also claim that the tenant hardship provisions place the burden of rent control disproportionately on some landlords, and therefore violate the equal protection clause. Appellants' Brief at 19-22. Because landlords are not a suspect class and San Jose's ordinance is purely economic regulation, however, any classification in the ordinance with some "rational relationship" to a legitimate public purpose is valid under the equal protection clause. *See*, *e.g.*, *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 461-63 (1981); *Williamson v. Lee Optical, Inc.*, 348 U.S. 483 (1955).[14/]

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[13] See id. at 125, citing Sax, Takings and the Police Power, 74 Yale L.J. 36 (1964). Appellants assert that in applying the tenant hardship provisions, San Jose is acting in its "enterprise capacity" rather than its "arbitral capacity," and therefore must compensate landlords. Yet rent control is clearly what Sax would deem "arbitral," because "it mediates the disputes of various citizens and groups within the society, and it resolves the conflict among competing and conflicting alternatives." Sax, supra, at 62. The government "in this function ... as between tenant and landlord ... may adjust prices." Id. at 62-63. Unlike the situation in which government acts as an economic participant, that is, as an "enterprise," the government's exercise of its "arbitral" police power requires no compensation. Rent control is no less arbitral when the rent formula distinguishes between needy and wealthy tenants; the government is still adjudicating disputes according to general rules designed to balance opposing interests, albeit in a manner more sensitive to a larger set of relevant factors.

Here, San Jose's tenant hardship provisions are rationally related to the legitimate purpose of providing affordable housing and focusing the benefits of rent control upon those who need it most.

Moreover, the city's decision to consider tenant hardship among a number of factors in its rent control ordinance rather than create a housing subsidy pro-

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[14/] As noted, *amici* believe that the San Jose ordinance "substantially" advances a legitimate state interest under the takings clause. *See supra* pp. 15-20. The equal protection standard for economic regulation is, if anything, more relaxed. *See Nollan*, 55 U.S.L.W. at 5147 n.3, *discussed supra* note 7.

gram for needy tenants is plainly rational given the administrative costs of such a subsidy program, and the comparative simplicity of adding one more relevant factor to a rent control formula that will be administered by an agency specifically created to regulate excessive rents.[15/]

The application of any rational price control rule will have some disparate impact among those affected. But this result is not of constitutional significance. *See*, *e.g.*, *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968) (upholding price controls that affected some

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[15/] These obvious administrative advantages are not present in the California reimbursement cases that the appellants rely upon to challenge the San Jose ordinance. Whereas a state can bear the costs of care for those incarcerated in state institutions simply by not charging the relatives and financing the cost through a preexisting tax structure, there is no such simple method for shifting the burden of rent control to the public; San Jose's only alternative was to superimpose a separate housing subsidy scheme that would be administered by an entirely new bureaucracy.

operators more seriously than others); Nebbia v. New York, 291 U.S. 502, 520-21 (1934); Cotati Alliance for Better Housing v. City of Cotati, 148 Cal. App. 3d 280, 195 Cal. Rptr. 825 (1983). Indeed, this Court has observed that "[l]egislation designed to promote the general welfare commonly burdens some more than others," but is nevertheless constitutionally permissible. Penn Central, 438 U.S. at 133. The relief of tenant hardship should not be treated any differently under the Constitution than any other object of general police power regulation.

Although cities and states may be barred from imposing taxes on arbitrarily selected groups, they are not obliged to scan all economic regulations for disparate impact and reimburse all individuals who happen to bear a heavier burden. Such a requirement would be intolerable, as this Court recognized in Penn Central. "'Government hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law' ...." Penn Central, 438 U.S. at 124, quoting Pennsylvania Coal Co. v. Mahon, 260 U.S. 393, 413 (1922).

Finally, appellants consistently mischaracterize the San Jose ordinance as "one-on-one subsidization" by "individual landlords" of "individual tenants."[16] In fact, individuals are affected only as members of classes, defined by general rules that are applied in individual administrative adjudications and that are reasonably related to the legitimate goal of affordable housing.

Forty years ago this Court considered

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[16] Appellants' Brief at 14, 17, 21-22, 25-26.

another rent control ordinance and wrote: "A member of the class which is regulated may suffer economic losses not shared by others. ... But that has never been a barrier to the exercise of the police power." Bowles v. Willingham, 321 U.S. 503, 518 (1944). That principle of law is equally valid today.

CONCLUSION

For the foregoing reasons, the decision of the California Supreme Court should be affirmed.

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BRIEF

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RICHARD PENNELL and TRI-COUNTY APARTMENT OWNERS ASSOCIATION,

Appellants,

v.

CITY OF SAN JOSE, et al.,

Appellees.

ON APPEAL FROM THE SUPREME COURT
OF THE STATE OF CALIFORNIA

BRIEF AMICUS CURIAE OF THE CITY OF SANTA MONICA

and the Cities and Towns of Berkeley, Capitola, Cathedral City, Cotati, Fontana, Hayward, Hemet, Los Gatos, Morgan Hill, Oakland, Oxnard, Palm Springs, San Buenaventura, San Francisco, San Luis Obispo, Santa Barbara, Thousand Oaks, Vallejo, and West Hollywood

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QUESTIONS PRESENTED

1. Whether landlords who have not invoked available administrative remedies in a rent control law, demonstrated that they have protectable property interests at stake, or shown that they are even subject to challenged provisions, present a justiciable case in which to reconsider the standard of review applicable to rate regulation cases?

2. Whether one factor available to an administrative agency in implementing a comprehensive regulatory scheme, which is presumably valid as a whole, can be isolated and found to constitute a taking, absent any evidence of its effect on prices, and absent any evidence of diminution of value or denial of reasonable economic use?

3. Whether a rent control law of general application, which yields a just and reasonable return on property in all cases, is nonetheless confiscatory or denies equal protection of the laws because additional or bonus rent increases beyond those constitutionally required may be tempered by considerations of tenant hardship?

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No. 86-753

In the Supreme Court of the United States

October Term, 1987

RICHARD PENNELL and TRI-COUNTY APARTMENT OWNERS ASSOCIATION,

Appellants,

v.

CITY OF SAN JOSE, et al.,

Appellees.

BRIEF AMICUS CURIAE OF THE CITY OF SANTA MONICA AND OTHER JOINING CITIES AND TOWNS IN SUPPORT OF APPELLEES

Pursuant to Supreme Court Rule No. 36.4, the California Cities and Towns of Santa Monica, Berkeley, Capitola, Cathedral City, Cotati, Fontana, Hayward, Hemet, Los Gatos, Morgan Hill, Palm Springs, San Buenaventura, San Francisco, Santa Barbara, Thousand Oaks, Vallejo, and West Hollywood, respectfully submit this brief amicus curiae in support of the City of San Jose.

INTEREST OF AMICI

Approximately three million privately owned residential rental units in the United States, representing 10-12% of the nation's total rental housing stock, are subject to rent control.[1] Rent controls were enacted at the national level during both world wars, and were briefly established by President Nixon in 1971 under the authority of the Economic Stabilization Act of 1970.[2] In 1973, Congress authorized the District of Columbia to adopt rent controls, which it did the following year.[3] On the local level, more than 200 jurisdictions, including some of the nation's largest cities, have enacted some form of rent control.

Amici are California cities which have implemented rent controls or income-sensitive housing programs for their citizens. Each of their enactments was in response to severe shortages of affordable housing in their communities. The housing crisis is particularly acute in California. *Cotati Alliance For Better Housing v. City of Cotati*, 148 Cal. App. 3d 280, 292-93, 195 Cal. Rptr. 825, 833 (1983). Given California's continued population growth and the exhaustion of vacant land available for additional housing in urban areas, California cities are under increasing pressure to enact effective measures to protect low- and moderate-income households.

Amici are concerned that they retain necessary flexibility to meet their obligation to protect the health and welfare of their citizens. Therefore, they urge this Court to affirm the decision of the California Supreme Court.[4]

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[1] *See* Baar, *Guidelines for Drafting Rent Control Lessons of A Decade*, 35 Rutgers L.Rev. 723, 725 n. 1 (1983) [hereinafter cited as *Guidelines*].

[2] Exec. Order No. 11615, 3 C.F.R. 602 (1971), 36 Fed. Reg. 15,727 (1971), implementing 12 U.S.C. Section 1904.

[3] *See* Act of Nov. 21, 1973, Pub. L.No. 93-157, 87 Stat. 623; D.C. Res. 74-20 (1974).

SUMMARY OF ARGUMENT

1. Appellants' resort to judicial review is premature. Because constitutional analysis of an economic regulation depends on whether it "goes too far," *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922), it is essential to first determine what effect a regulation has on a property owner. *MacDonald, Sommer & Frates v. Yolo County*, ___ U.S. ___, 106 S. Ct. 2561, 2566 (1986). There is no basis for meaningful review of appellants' taking claim since appellants have entirely bypassed the administrative process and obtained judgment on pleadings devoid of any facts.

2. The case is non-justiciable because it is moot as to the named appellant and the associational appellant lacks standing. Appellants nowhere allege injury occasioned by the San Jose tenant hardship provisions.

3. Appellants have failed to establish a protectable property interest. A landlord's interest in a hypothetical element of undefined future rent increases does not constitute a protected property interest. This Court has rejected as "untenable" claims that speculative gain is guaranteed by the Fifth and Fourteenth Amendments. *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 130 (1978).

4. The San Jose ordinance substantially advances a legitimate public purpose and guarantees appellants a fair return on their properties. Tempering large rent increases in cases of tenant hardship, as part of a comprehensive regulatory framework, directly furthers the City's important goal of preventing hardship and displacement caused by excessive rents.

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[4] None of amici have enacted tenant hardship provisions akin to San Jose's. Yet, they support appellee's determination that such provisions are valid in appropriate cases.

5. Appellants are not forced to bear a "public burden." That term of art is the consequence of an uncompensated taking. The severity of their "burden" is crucial to a takings analysis, yet incapable of assessment on this record.

Appellants improperly isolate the incremental rent that may be affected by the hardship provision, and argue that it constitutes a separate property interest which is taken. Yet this Court has rejected the notion that property may be divided into separate estates for takings analysis.

6. In rate regulation cases, the due process clause requires only that results lie within a "broad zone of reasonableness." Invalidation on the basis of substantive due process is exceptionally rare, occurring only where a law is arbitrary or demonstrably irrelevant to governmental policy. The safeguard of a "fair return" for each landlord, expressed in the San Jose law, satisfies due process.

7. Similarly, in equal protection cases, this Court requires only that legislation be rationally related to a legitimate end. Denying just those increases which cause particular hardship perfectly fits San Jose's purpose.

INTRODUCTION

This case is the first constitutional challenge to rent control laws heard by this Court in nearly 40 years.[5] It appears to be the first case ever involving the constitutionality of specific standards for determining the amount of rent chargeable by a landlord.[6] Yet, as early as the "Rent Law" cases of the 1920s, the Court determined that rent control was a valid exercise of both national and state powers. "Housing is a necessary of life. All the elements of a public interest justifying some degree of public control are present." *Block v. Hirsh*, 256 U.S. 135, 156 (1921) (Holmes, J.).

In a second series of cases challenging the renewal of national rent controls during the 1940's, the Court was even stronger in its support for the breadth of legislative power. *See Bowles v. Willingham; Woods v. Cloyd W. Miller Co.* Since then, significant litigation has taken place in state and lower federal courts involving "second generation" rent controls.[7] The decision below is consistent with these precedents.[8]

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[5] In *Woods v. Cloyd W. Miller Co.*, 333 U.S. 138 (1948), the Court sustained the Housing and Rent Act of 1947 against the charge that Congress lacked Article I power to enact rent control upon expiration of the declaration of war. The only other rent control case heard since World War II examined a municipal ordinance under the Sherman Antitrust Act (15 U.S.C. Section 1). *Fisher v. City of Berkeley*, 475 U.S. 260 (1986). A constitutional challenge to the Berkeley law was dismissed for lack of a substantial federal question. 471 U.S. 1114 (1985).

[6] As in *Woods*, prior cases dealt with the constitutional power to enact rent control, not with constitutional limits on that power. *See Yakus v. United States*, 321 U.S. 414 (1944); *Chastleton Corp. v. Sinclair*, 264 U.S. 543 (1924); *Edgar A. Levy Leasing Co. v. Siegel*, 258 U.S. 242 (1922); *Marcus Brown Holding Co. v. Feldman*, 256 U.S. 170 (1921); *Block v. Hirsh*, 256 U.S. 135 (1921). Rent ceilings were considered in *Bowles v. Willingham*, 321 U.S. 503 (1944), where this Court unanimously upheld the Emergency Price Control Act. But the Court did not "determine what constitutional limits there are to price-fixing legislation." *Id.* at 519.

[7] So called because they go beyond merely alleviating war time conditions, and seek to address housing crises resulting from other causes. *See, e.g.*, Gilderbloom, *Moderate Rent Control*, 17 Urb. Aff. Q. 123 (1981) [hereinafter cited as *Gilderbloom*].

[8] Two other state high courts have considered the constitutionality of rent control laws which provided differential rent increases based on tenant income. *Property Owners Ass'n v. North Bergen TP.*, 74 N.J. 327, 378 A.2d 25 (1977); *Parrino v. Lindsay*, 29 N.Y.2d 30, 323 N.Y.S.2d 689, 272 N.E.2d 67 (1971). Several other cases have upheld the validity of special rent protections for low-income tenants. These are discussed post, Sections IIB and III.

The San Jose Law and Its Effect on Appellants

The San Jose rent control law permits five levels or tiers of rent increases. The first four are:

1. Unlimited increase upon vacancy (Section 5703.3(b)).

2. Eight percent (8%) annual rent increases (Section 5703.5).

3. Increase for capital improvements, increased operating expenses, plus an additional 5% (Section 5703.28(a)).

4. Increased debt service (Section 5703.28(b)).

These rent increase items are similar to (but more generous than) those contained in other rent control laws.[9]

In addition, San Jose permits additional, or fifth tier, rent increases for a variety of factors, some of which are redundant to the first four tiers,[10] and some of which are not even permissible grounds for rent increases in most other rent control laws.[11] It is only in this fifth tier (Section 5703.28(c)) where tenant hardship is a possible mitigating factor, and then only if a tenant files a petition seeking administrative review of the reasonableness of the increase.[12]

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[9] Most rent control laws provide automatic annual rent increases, although few are as high as 8%, since that is approximately twice the current inflation rate. Similarly, most laws provide for increases in operating expenses and improvements. Some laws allow for rent increases upon vacancy. On the other hand, direct pass-through of increased debt service is unusual. *See Fisher v. City of Berkeley*, 37 Cal. 3d 644, 691-92, 693 P.2d 261, 299, 209 Cal. Rptr. 682, 720 (1984) (mortgage pass-through provisions may result in "windfall returns" to landlords).

[10] Sections 5703.28(c)(1) and (c)(2) seem to consider the same factors which generate rent increases under Sections 5703.28(b) and 5703.4, respectively.

[11] E.g., Section 5703.28(c)(6) ("market value of rents"). *See Cotati Alliance for Better Housing v. City of Cotati*, 148 Cal. App. 3d at 287, 195 Cal. Rptr. at 830.

Distilled to its essence, appellants complain that rent increases they would likely not even be eligible for elsewhere are granted in San Jose, but are theoretically tempered by concerns for tenant hardship. Yet, so long as appellants' earnings remain within a constitutionally permissible "zone of reasonableness," it is no objection that some may realize greater return than others, whether based on the fortuity of particular rent history,[13] tenure of tenancy,[14] financing arrangements,[15] number of units in the building,[16] or the hardship status of tenants.[17]

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[12] The unlimited vacancy increase and 8% annual "general adjustment" are self-executing. The other rent increases may also be imposed unilaterally, but the tenant has the right to challenge their reasonableness by filing a petition pursuant to the Rent Dispute Mediation and Arbitration Hearing Process (Section 5703.6). Rent increases for increased expenses (tier 3) and most increases in debt service (tier 4) are "deemed reasonable" and the landlord is presumptively entitled to them. Sections 5703.28(a), (b).

[13] The San Jose rent control law, like most others, does not fix rents. Rather, it determines the amount of allowable *increase*. Section 5073.4. Thus, the rent in effect prior to imposition of the law ("base rent") is the principal determinant of actual rent level at any point in time. Since base rents in an unregulated market differ widely, even for comparable housing, disparity among landlords will persist under almost any rent control system, as it does on the open market.

[14] In jurisdictions where additional rent increases are permitted upon vacancy of a unit (such as San Jose), rent disparity is inevitably occasioned by uneven distribution of vacancies, particularly among smaller buildings.

[15] The San Jose law allows rent increases for changes in debt obligation. Section 5703.28(b).

[16] The San Jose law exempts buildings with two or fewer units. Section 5702.12(d). Similar exemptions are common to rent control laws.

[17] Of all the factors appellants could identify as influencing the amount of rent receivable under the San Jose law, the tenant

I.

THIS CASE DOES NOT PROPERLY PRESENT A FEDERAL QUESTION

A. This Case is Not Ripe for Adjudication Under the Takings Clause.

This Court has often held that before it will review a claim that a regulation has affected a taking of property in violation of the Fifth Amendment, the administrative agency charged with enforcing the challenged regulation must have first reached a final, definitive position as to how it will apply the regulation to the affected property. *First English Evangelical Lutheran Church v. County of Los Angeles*, 55 U.S.L.W. 4781, 4783-84 (U.S. June 9, 1987); *MacDonald, Sommer & Frates v. County of Yolo*, 106 S. Ct. 2561, 2566-67; *Williamson Planning Comm'n v. Hamilton Bank*, 473 U.S. 172, 186-88 (1985); *San Diego Gas & Electric Co. v. San Diego*, 450 U.S. 621, 631-32 (1981); *Agins v. Tiburon*, 447 U.S. 255 (1980).[18]

Not only have appellants failed to seek from San Jose the very relief they demand here, they have neglected to put any facts in the record which are crucial to takings cases.

B. This Case Is Not Justiciable as a Facial Challenge.

Due to appellants' failure to pursue administrative processes, "the only question properly before [the Court] is whether the mere enactment of the . . . ordinance constitutes a taking." *Agins v. Tiburon*, 447 U.S. at 260. However, even this facial analysis requires a greater showing than appellants have made here. They have failed to demonstrate three key elements of a takings claim: (1) that they are subject to the challenged ordinance;[19] (2) that they have a protected property interest at stake; and (3) that the ordinance has had any effect on them at all. Factual inquiries are particularly necessary in rent control cases because "statutes regulating the economic relations of landlords and tenants are not per se takings." *FCC v. Florida Power Corp.*, ___ U.S. ___, 107 S. Ct. 1107, 1112 (1987) (citing Supreme Court rent control cases).

Keystone Bituminous Coal Ass'n v. DeBenedictis, ___ U.S. ___, 107 S. Ct. 1232 (1987), stresses the "especially steep hill" which challengers must overcome in facial takings cases, even where they assert a lack of public purpose. *Id.* at 1247. There, as here, since "the record [was] devoid of any evidence" tending to show severe economic impact, plaintiffs were unable to "satisfy their heavy burden." *Id.* at 1250-51.[20]

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hardship considerations of Sections 5703.28 and 5703.29 undoubtedly have the least quantitative effect. Indeed, there is no showing that it has even had any effect at all.

[18] The ripeness requirement also applies to appellants' due process claim. *Hamilton Bank*, 473 U.S. at 185 (same ripeness requirement "whether we examine the . . . regulations under the Fifth Amendment 'taking' jurisprudence, or under the precept of due process").

[19] The complaint alleges that appellants "are subject to the terms of the San Jose Rental Dispute Mediation and Arbitration Ordinance." CT at 2. Yet nowhere do appellants allege that they rent to tenants who would be covered by San Jose Municipal Code Section 5703.29, i.e., "[a]ny tenant whose household income and monthly housing expense meets the criteria established by the Housing Assistance Payments Program under Section 8, existing housing provisions of the Housing and Community Development Act of 1974 (P.L. 93-383)," or a tenant who can overcome the presumption in favor of the landlord and demonstrate "an unreasonably severe financial or economic hardship." Nor have appellants alleged that they have been denied, or are likely to be denied, a rent increase pursuant to the hardship provision.

[20] Appellants' argument, that the legitimacy of the state interest and advancement of that interest are suitable for facial review, is rebutted by *Keystone*. Moreover, even this strand of regulatory takings analysis "necessarily requires a weighing of private and public interests," *Agins v. Tiburon*, 447 U.S. at 261, which cannot be accomplished on this record. Appellants can offer no reason why this takings case is different than any other in which the analysis

Similarly, if the instant case is justiciable at all on the current record, it is easily resolvable employing the "fairly straightforward" test of *Agins*. *Hodel v. Virginia Surface Min. & Recl. Ass'n*, 452 U.S. 264, 295 (1981). Since there is no allegation that the law denies an owner economically viable use of his land, appellants' "facial attack under the takings clause must surely fail." *Keystone*, 107 S. Ct. at 1251.

C. Appellants Lack Standing.

Amici are informed that Richard Pennell no longer owns rental property in the City of San Jose. As to him, the case is now moot. *DeFunis v. Odegaard*, 416 U.S. 312 (1974). The associational appellants, while presumably still interested in the subject matter of the litigation, lack standing to press a takings claim. Although normally "an association may have standing solely as the representative of its members," ***Warth v. Seldin***, 422 U.S. 490, 511 (1975), the nature of takings claims as "ad hoc factual inquiries," ***Penn Central***, 438 U.S. at 124, makes such standing highly inappropriate in taking cases. In ***Warth***, this Court stated that at a minimum an "association must allege that its members, or any one of them, are suffering immediate or threatened injury." 422 U.S. at 511. The Court also recognized that the "nature of the claim" may "make the individual participation of each injured party indispensable to proper resolution of the cause." *Id.* Here the complaint is remarkably deficient as to injury. CT at 2. All that it alleges is that "members of the . . . ASSOCIATION are subject to the terms of the . . . Ordinance."[21] Takings claims require substantially more than this. Any number of undisclosed factors might be dispositive in this case. Do

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"depends largely 'upon the particular circumstances in that case.' " *Penn Central*, 438 U.S. at 124 (citations omitted).

[21] Even this allegation carries no evidentiary weight under California law since the complaint was not verified by a party. Cal. Civ. Pro. Code Section 446 (West Supp. 1987). *See* CT at 8.

association members rent to hardship tenants? Have they ever sought, or are they entitled to, fifth tier rent increases? Did they purchase their properties before or after enactment of the ordinance? If after, surely their "investment-backed expectations" contemplated the very law they attack. In sum, given the nature of the claim, associational appellants have made out none of the elements of a justiciable case. *Sierra Club v. Morton*, 405 U.S. 727, 739 (1972).[22]

D. Appellants Have Not Established That Their Economic Interests Constitute Property for Fifth Amendment Purposes.

An obvious prerequisite in takings cases is that the claimants have a protectable "property" interest which has been adversely affected by government action. *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1001 (1984); *Kaiser-Aetna v. United States*, 444 U.S. 164, 175 (1979); *United States v. Willow River Power Co.*, 324 U.S. 499 (1945). Because there are no specific claimants, and because the record is barren of facts, the contours of any property interests before the Court are unknown.[23]

Appellants and their amici rely on *Monongahela Navigation Co. v. United States*, 148 U.S. 312 (1893) for the proposition that rents constitute property for Fifth Amendment purposes.[24] Yet they fail to note a critical distinction in just compensation cases between existing and future rents. *Andrus v. Allard,* 444 U.S. 51, 66 (1979). The "property" allegedly taken in this case is hypothetical rental income; not income or a right to income pre-existing enactment of the law, but a potential increment in future income. It is not a *res* or even an inchoate entitlement; it is a conjectural opportunity. It forms no element in Fifth Amendment law. *United States v. Powerlson,* 319 U.S. 266, 282 (1943) (distinguishing *Monongahela*). Thus, future estimated rents are traditionally excluded for valuation purposes in eminent domain proceedings "because of the speculative character of such evidence." 5 Nichols, *Eminent Domain,* 19-31 (1985) (citing *United States v. 75.13 Acres of Land,* 693 F.2d 813 (8th Cir. 1982)). "Such income is too uncertain and conjectural to be acceptable." Nichols at 19-7. This is the long-standing rule in California. *San Diego Land & Town Co. v. Neale,* 88 Cal. 50, 62, 25 P. 977, 980-81 (1891).

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[22] Granting associational standing here is doubly inappropriate after *First English Evangelical Lutheran Church v. County of Los Angeles*, because a finding of taking seemingly entitles the property owner to damages. While the instant case nominally seeks declaratory and equitable relief for which associational standing is more readily granted, ***Warth***, 422 U.S. at 511, *Lutheran Church* may transform it into a damage claim, in which case associational standing is generally denied. ***Warth***, 422 U.S. at 516.

[23] This Court has long held that the Constitution neither creates nor defines property. *Ruckelshaus v. Monsanto Co.*, 467 U.S. at 1001 ("property interests . . . are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law").

Appellants' reliance on *Webb's Fabulous Pharmacies, Inc. v. Beckwith,* 449 U.S. 155 (1980) is also misplaced. There, owners of a fund placed in court pursuant to a state interpleader statute had been deprived of all rights in that fund pending court proceedings. This Court rightly held that "earnings of a fund are incidents of ownership." *Id.* at 164. But that ownership consisted of identifiable income, not a particular rate or even a higher rate which might be earned elsewhere. Compare *Getty Oil Co. v. United States,* 757 F.2d 886 (Fed. Cir. 1985) (rejecting Fifth Amendment claim for interest on funds held by United States where no identifiable interest was earned). Thus, while a "radical curtailment of a landowner's . . . ability to derive income from his land may give rise to a taking," *Kirby Forest Industries v. United States,* 467 U.S. 1, 14 (1984), not all expectations of earnings are constitutionally enshrined. *Penn Central,* 438 U.S. at 130; *United States v. Grand River Dam Authority,* 363 U.S. 229, 236 (1960) ("frustration and appropriation are essentially different things").

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[24] *Monongahela* has been limited by subsequent cases in a manner that makes the case irrelevant here. *Pruneyard Shopping Center v. Robbins,* 447 U.S. 74, 84 n. 7 (1980); *Kaiser-Aetna,* 444 U.S. at 189, n. 6.

Even if the unfettered ability to raise future rents might in some cases be considered property, such determination necessarily depends on each claimant's "investment backed expectation." *Penn Central,* 438 U.S. at 125. Without this, appellants cannot show "the presence of a legally enforceable and recognizable interest in distinct property." *Peick v. Pension Benefit Guaranty Corp.,* 724 F.2d 1247, 1375 (7th Cir. 1983). *See also Ruckelshaus v. Monsanto,* 467 U.S. at 1006; *Cone v. State Bar of Florida,* ___ F.2d ___, No. 85-3993 (11th Cir. June 19, 1987).

It would be difficult indeed for appellants to establish that, under California's landlord-tenant regulatory environment, they had an "investment-backed expectation" to bonus rent increases in excess of the four automatic levels provided by the unchallenged provisions of the ordinance. Indeed, entitlement to the fifth-tier increase is established in the very regulation challenged.[25]

Moreover, if rents allowed by the San Jose law are already at or above market level, appellants would be unable to collect the higher rents they demand here. Any property loss nominally caused by the tenant hardship factor would be that rents constitute property for Fifth Amendment purposes.[24] Yet they fail to note a critical distinction in just compensation cases between existing and future rents. *Andrus v. Allard*, 444 U.S. 51, 66 (1979). The "property" allegedly taken in this case is hypothetical rental income; not income or a right to income pre-existing enactment of the law, but a potential increment in future income. It is not a *res* or even an inchoate entitlement; it is a conjectural opportunity. It forms no element in Fifth Amendment law. *United States v. Powerlson*, 319 U.S. 266, 282 (1943) (distinguishing *Monongahela*). Thus, future estimated rents are traditionally excluded for valuation purposes in eminent domain proceedings "because of the speculative character of such evidence." 5 Nichols, *Eminent Domain*, 19-31 (1985) (citing *United States v. 75.13 Acres of Land*, 693 F.2d 813 (8th Cir. 1982)). "Such income is too uncertain and conjectural to be acceptable." Nichols at 19-7. This is the long-standing rule in California. *San Diego Land & Town Co. v. Neale*, 88 Cal. 50, 62, 25 P. 977, 980-81 (1891).

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[25] Appellants' treatment of Section 5703.28(c) is misleading. They claim that the first six factors create an entitlement to a rent increase, which can then be expunged by the seventh factor (tenant hardship). Appellants cannot pick and choose among the various provisions in this manner. The ordinance was enacted as a whole. If it creates an entitlement to or expectation of a rent increase, it is only upon consideration of all factors, not just those which are to appellants' liking.

Appellants' reliance on *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980) is also misplaced. There, owners of a fund placed in court pursuant to a state interpleader statute had been deprived of all rights in that fund pending court proceedings. This Court rightly held that "earnings of a fund are incidents of ownership." *Id.* at 164. But that ownership consisted of identifiable income, not a particular rate or even a higher rate which might be earned elsewhere. Compare *Getty Oil Co. v. United States*, 757 F.2d 886 (Fed. Cir. 1985) (rejecting Fifth Amendment claim for interest on funds held by United States where no identifiable interest was earned). Thus, while a "radical curtailment of a landowner's . . . ability to derive income from his land

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[24] *Monongahela* has been limited by subsequent cases in a manner that makes the case irrelevant here. *Pruneyard Shopping Center v. Robbins*, 447 U.S. 74, 84 n. 7 (1980); *Kaiser-Aetna*, 444 U.S. at 189, n. 6.

may give rise to a taking," *Kirby Forest Industries v. United States*, 467 U.S. 1, 14 (1984), not all expectations of earnings are constitutionally enshrined. *Penn Central*, 438 U.S. at 130; *United States v. Grand River Dam Authority*, 363 U.S. 229, 236 (1960) ("frustration and appropriation are essentially different things").

Even if the unfettered ability to raise future rents might in some cases be considered property, such determination necessarily depends on each claimant's "investment backed expectation." *Penn Central*, 438 U.S. at 125. Without this, appellants cannot show "the presence of a legally enforceable and recognizable interest in distinct property." *Peick v. Pension Benefit Guaranty Corp.*, 724 F.2d 1247, 1375 (7th Cir. 1983). *See also Ruckelshaus v. Monsanto*, 467 U.S. at 1006; *Cone v. State Bar of Florida*, ___ F.2d ___, No. 85-3993 (11th Cir. June 19, 1987).

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Moreover, if rents allowed by the San Jose law are already at or above market level, appellants would be unable to collect the higher rents they demand here. Any property loss nominally caused by the tenant hardship factor would be wholly illusory.[26] This may be apparent from the face of the San Jose ordinance, which has permitted 71.4% just in automatic annual rent increases since 1979, while during the same period national rents increased 59%. U.S. Bureau of the Census, *Statistical Abstract of the United States, 1987*, Table No. 775, p. 463. Indeed, the Consumer Price Index increased during this period just 50.9%. *Id.*

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II.

THE SAN JOSE LAW DOES NOT CAUSE A REGULATORY TAKING OF PROPERTY

Modern "takings" jurisprudence originated with Justice Holmes' statement in *Pennsylvania Coal Co. v. Mahon*, that regulation under the police power which goes further than necessary for the public welfare would be recognized as a "taking." 260 U.S. at 261. However, rather than relying on particular formulations, this Court focuses on the character of the governmental action and the extent to which it interferes with the property owner's reasonable investment-backed expectations. *Penn Central*, 438 U.S at 124.

This analysis cannot be performed here since appellants have not introduced any evidence tending to show elements of a regulatory taking. Instead, appellants attempt to revive the argument advanced by Pennsylvania Coal in *Mahon* in challenging Pennsylvania's Kohler Act, which prohibited mining that caused subsidence under certain structures. In *Mahon*, the company argued, in terms similar to those employed here, that the Act was an invalid exercise of the police power; that it was "robbery under the forms of law," because its purpose was "not to protect the lives or safety of the public generally but merely to augment the property rights of a favored few." 260 U.S. at 397-98. Although the Court agreed the Act did not advance a public interest, it rested its holding on what it viewed as the complete extinction of a "very valuable estate" in land. *Id.* at 414.

Recent land use cases contain similar elements. *Agins v. Tiburon*, 447 U.S. at 260 (ordinance causes a taking if it "does not substantially advance legitimate state interests . . . or denies an owner economically viable use of his land"). But while the second factor is essentially the same as formulated in *Mahon*, appellants ignore the fact that the Court's role in assessing the first factor — the public interest — has shifted greatly.

A. Regulatory Taking Cases Properly Employ A Deferential Standard of Review.

The concept of the "public interest," so narrowly defined during the *Lochner* era of economic substantive due process, is now greatly expanded. *See Nollan v. Coastal Comm'n*, 55 U.S.L.W. 5145, 5147 (U.S. June 26, 1987) ("a broad range of governmental purposes and regulations satisfies [the public interest] requirement"); *Andrus v. Allard*, 444 U.S. at 59 (in passing measures for the people's protection pursuant to the police power, the legislature is the judge of the necessity or expediency of the means adopted); *Ferguson v. Skrupa*, 372 U.S. 726, 731 (1963) (legislature "was free to decide for itself" what legislation was needed to advance the public interest); *Day-Brite Lighting v. Missouri*, 342 U.S. 421, 424-425 (1952). *See also Ruckelshaus v. Monsanto*, 467 U.S. at 1014; *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 418 n. 25 (1983); *Nebbia v. New York*, 291 U.S. 502, 537 (1934).

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[26] Although uncommon, certain rent control laws may not in fact suppress rents below market value. For instance, a study of the Los Angeles Rent Stabilization Law showed that rent levels had risen "only slightly more slowly during the period of rent stabilization than have average rents in surrounding unstabilized areas." City of Los Angeles Rent Stabilization Division, *Rental Housing Study* i (1984). The study showed that stabilized rents had risen overall only two-tenths of one percent less per year than their unstabilized counterparts. *Id.* at ii. Indeed, because of vacancy deregulation, stabilized rents for recent tenants were often higher than market rents. *Id.* at v. The San Jose rent control law is more generous than Los Angeles'. *See* n. 9-16, *ante*.

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The approach is similar in land use regulation cases. *See, e.g., Penn Central,* 438 U.S. at 133 n. 29 ("judicial inquiry focuses upon whether the challenged restriction can reasonably be deemed to promote the objectives of the [legislation]"). However, in *Nollan v. California Coastal Comm'n,* this Court announced a stricter test where possessory takings were involved. In such cases, the Court stated it would be particularly careful in analyzing the means-end relationship, requiring a "substantial" nexus. 55 U.S.L.W. at 5149. But since this case does not involve an "actual conveyance of property" (*id.*),[27] traditional deferential review is appropriate.[28] In any event, even the *Nollan* standards are easily satisfied here.

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[27] Appellants' Brief (AB) presses a second taking claim not raised below or decided by the California courts. Relying on *Loretto v. Teleprompter Manhattan ATV Corp.*, 458 U.S. 419, 428 (1982), they now state that anti-eviction provisions in a rent control law are tantamount to a physical invasion of land, which effectuates a taking irrespective of economic consequences. Compare AB at 7, 29-30 with Complaint, CT at 4. Although not properly presented by this case, amici note that the precise issue may shortly be before this Court. *See Hall v. City of Santa Barbara,* 797 F.2d 1493 (9th Cir. 1986), *petition for cert. due Aug. 6, 1987,* sub nom *City of Santa Barbara v. Hall* (No. A-828). Similar constitutional claims have been rejected by this Court in two recent cases involving challenges to rent control ordinances. *Nash v. City of Santa Monica,* 37 Cal. 3d 97, 207 Cal. Rptr. 285, 688 P.2d 894 (1984), *appeal dismissed for lack of substantial federal question,* 470 U.S. 1046 (1985); *Fresh Pond Shopping Center v. Callahan,* 464 U.S. 875 (1983) [appeal dismissed] (Rehnquist, J. dissenting).

[28] Heightened scrutiny of the type used in *Nollan* may be appropriate in permanent physical occupation cases because such governmental action is tantamount to complete extinction of all property interests. *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. at 435. This is a far cry from the instant situation where the landlords retain all essential attributes of property, particularly the ability to derive value.

B. San Jose Pursues Valid Public Purposes In Maintaining The Affordability Of Housing For Low-Income Tenants And Preventing Displacement Caused By Excessive Rent Increases.

San Jose has determined that maintaining affordable rents so as to avoid displacement of low-income tenants is in the public interest. That this satisfies the public purpose requirement was affirmed by Justice Holmes in *Block v. Hirsch.* "[A] declaration by a legislature concerning public conditions that, by necessity and duty, it must know, is entitled at least to great respect [by the courts]." 256 U.S. at 154. Thus, Justice Holmes had no difficulty in finding modern housing conditions a matter of public concern. "Housing is a necessary of life. All the elements of a public interest justifying some degree of public control are present." *Id.* at 156.

The San Jose ordinance states an overriding public interest, *inter alia* "to protect the health, safety and welfare of the citizens of San Jose" which are jeopardized by a growing housing shortage and further exacerbated by "excessive and unreasonable rent increases." Section 5701.2. San Jose may have concluded that without special protection, low-income tenants might be forced out of their homes, thereby upsetting a desired demographic mix beneficial to the whole community. Or, displaced low-income tenants may contribute to a worsening homeless problem, which already strains the resources of many cities. Or, that the effect of rapidly increasing rents for those least able to afford them could trickle down and drain other community resources.[29]

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[29] "It is of course, 'constitutionally irrelevant whether this reasoning in fact underlay the legislative decision.' " *U.S. Railroad Retirement Board v. Fritz,* 449 U.S. 166, 179 (1980) (citations omitted). Nor is it necessary that these public purposes appear on the face of the ordinance. *Id. See Olsen v. Nebraska,* 313 U.S. 236, 246 (1941).

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The evident public purpose behind rent control does not become less so merely because a class of individuals (here hardship tenants) is singled out for greater protection. Landlord-tenant legislation providing special tenancy protection for elderly and low-income tenants has been held to serve a legitimate public purpose. *See Ballard v. Rockville Centre Housing Authority*, 605 F.2d 1283, 1287 (2d Cir. 1979) ("the objective of the rent differential—spreading the cost of public housing among those best able to absorb it—is clearly a legitimate governmental purpose"); *Frischman v. Durand*, 350 F. Supp. 79, 84 (S.D.N.Y., 1972) ("[a] classification based on income in these circumstances is so clearly reasonable as to be beyond serious question. . . . Keeping the rent level of the low income group down is a salutary purpose"); *Bucho Holding Co. v. Temporary State Housing Rent Comm'n*, 11 N.Y.2d 469, 474, 184 N.E.2d 569, 571 (1962) (legitimate legislative purpose in preventing "exactions of unjust, unreasonable and oppressive rents" which result in "uncertainty, hardship and dislocation").

Appellants complain that the San Jose law is not for the benefit of the public, but only for "specific tenants." This Court was unpersuaded by a similar argument in *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229 (1984). There, the fact that the immediate beneficiaries of the state's program were individual tenants did "not condemn [it] as having only a private purpose." *Id.* at 243. *See also West Coast Hotel v. Parrish*, 300 U.S. 379, 398 (1937) (sustaining minimum wage law for women: "[t]he legislature . . . was clearly entitled to consider the situation of women in employment, the fact that they are in the class receiving the least pay, that their bargaining power is relative weak, and that they are . . . ready victims"); *Home Building & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 444 (1934) (rejecting contracts clause challenge to Minnesota mortgage moratorium law enacted to provide relief to homeowners threatened with foreclosure; law was enacted to protect a basic societal interest, not a favored group). As was observed in *Fisher v. City of Berkeley*, 475 U.S. 260, ___, 106 S. Ct. 1045, 1048 (1986), rent control is simply one manifestation of "the function of government [which] may often be to tamper with free markets, correcting their failures and aiding their victims."

San Jose is not alone in its determination of the public interest. New York City reached similar conclusions in enacting its Senior Citizen Rent Increase Exemption Law,[30] and the California Legislature has long recognized the need to provide persons of restricted income with basic housing protection. *See* California Government Code Section 65580 ("early attainment of decent housing and a suitable living environment for every California family is a priority of the highest order"); California Health & Safety Code Sections 33250 and 50002.[31]

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[30] "[H]ardships imposed upon [low-income seniors] adversely affect their health and welfare and the general welfare of the inhabitants of the city." Cited in *Parrino v. Lindsay*, 29 N.Y.2d at 33 n.1, 323 N.Y.S.2d at 690 n.1, 272 N.E.2d at 68 n.1 (1971).

[31] The state does more than set policy. It also requires that each city "prepare and implement housing elements which, along with federal and state programs, will move toward attainment of the state housing goal." California Government Code Section 65581(b). Each housing element "shall make adequate provisions for the existing and projected needs of all economic segments of the community." California Government Code Section 65583. Non-compliance by cities carries severe penalties. California Government Code Section 65755(a) (suspension of local regulatory powers).

But while the state legislature mandates that cities preserve housing opportunities for all economic segments, the state constitution virtually disables cities from raising taxes to generate revenues to accomplish this. California Constitution Article XIIIA (restriction on property taxes); Constitution Article XIIIB (voter approval required for spending increase); Constitution Article XXXIV (voter approval required for housing projects). At the same time, the private production of housing which is affordable to lower income groups has been severely curbed. *See, e.g.*, Report of the President's Commission on Housing, *State and Local Housing*, ch. 15 (1982). In an era where the private sector is unresponsive to demands for low-income housing, and where federal and state

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Congress has also noted the special needs of this segment of the renter population. "The Congress finds and declares that . . . there is a shortage of adequate and affordable housing throughout the nation, especially for low-and moderate-income and elderly and handicapped persons." 15 U.S.C. 3601(a). *See* Housing and Community Development Act of 1974, 42 U.S.C. Section 1437 (P.L. 93-383); National Housing Act, 12 U.S.C. Section 1713(b)(2). *See also* 24 CFR Sections 221.531(c) and 570.303.

C. Restricting Rent Increases In Cases Of Tenant Hardship Substantially Advances The Public Interest In Preventing Excessive Rent Increases And Securing Affordable Housing.

"[I]f the public interest be established, the regulation of rates is one of the first forms in which it is asserted." *Block v. Hirsh,* 254 U.S. at 157. The highest courts of Massachusetts, New Jersey, New York, California, and Maryland have reached similar conclusions.[32]

The history of judicial approval of rent control provides compelling precedent for San Jose's decision to protect "hardship" tenants. Nonetheless, appellants contend that considerations of tenant hardship in determining rent

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funding has been substantially reduced, San Jose, like other California cities, is caught between Scylla and Charybdis. Fortunately, the Constitution is accommodating. "The problems of government are practical ones and may justify, if they do not require, rough accommodations—illogical, it may be, and unscientific." *Metropolis Theatre Co. v. City of Chicago,* 228 U.S. 61, 69-70 (1913).

[32] *Marshall House v. Rent Review & Grievance Bd.,* 357 Mass. 709, 260 N.E.2d 200 (1970); *Inganamort v. Borough of Fort Lee,* 62 N.J. 521, 303 A.2d 298 (1973); *Felner v. Office of Rent Control,* 27 N.Y.2d 692, 314 N.Y.S.2d 11, 262 N.E.2d 271 (1970); *Birkenfeld v. City of Berkeley,* 17 Cal. 3d 129, 130 Cal. Rptr. 465, 550 P.2d 1001 (1976); *Westchester West v. Montgomery County,* 276 Md. 448, 348 A.2d 856 (1975).

increases does not substantially advance the public interest. The public purpose of rent control is two-fold: to avoid hardship caused by excessive rent increases, while also guaranteeing a fair return to the landlord. In this context, San Jose's decision to temper rent increases so as to avoid hardship provides a perfect fit between means and ends. This is particularly true with the San Jose law because of the limited range of rent increases which are subject to mitigation. Only fifth-tier increases which are, by design, beyond the amount necessary to provide landlords with a constitutional fair return, can be affected by hardship concerns.[33] Since the first four tiers of rent increases authorized by appellee are already greater than most other rent control laws, any additional rent increase has a propensity to be excessive.

Appellants' amici go to great lengths attempting to establish the disutility and lack of public purpose of rent control in general, subjecting it to heightened scrutiny along the way. Not only are their political-economic attacks disputed,[34] they

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[33] *See* San Jose Resolution No. 59907 (June 16, 1987) (affirming that tenant hardship provision cannot be used to deny landlord a fair return).

[34] *See, e.g.,* Baar, *Facts and Fallacies in the Rental Housing Market,* Western City, Vol. 62, no. 9, p. 47 (Sept. 1986) (multi-family housing construction in rent control communities exceeds that in communities without rent control); Gilderbloom, *ante,* (rent controls do not deter new construction or housing maintenance); Harbridge House Inc., *A Study of Rent and Eviction Controls in the Commonwealth of Massachusetts,* p. ES-2 (1974) ("statistical evidence analyzed in this study indicates that there is no sound justification for the repeal of [rent control]. None of the available data demonstrates that rent control harms more people than it helps, or that it significantly impairs the supply of rental housing"); Marcuse, *The Uses and Limits of Rent Regulation* (A Report to Division of Housing and Community Renewal, State of New York, 1986) (rent control does not deter new construction; abolition of rent control would drive the poor out of New York City); Weitzman, *Economics and Rent Regulation: A Call for a New Perspective,*

Congress has also noted the special needs of this segment of the renter population. "The Congress finds and declares that . . . there is a shortage of adequate and affordable housing throughout the nation, especially for low-and moderate-income and elderly and handicapped persons." 15 U.S.C. 3601(a). *See* Housing and Community Development Act of 1974, 42 U.S.C. Section 1437 (P.L. 93-383); National Housing Act, 12 U.S.C. Section 1713(b)(2). *See also* 24 CFR Sections 221.531(c) and 570.303.

C. Restricting Rent Increases In Cases Of Tenant Hardship Substantially Advances The Public Interest In Preventing Excessive Rent Increases And Securing Affordable Housing.

"[I]f the public interest be established, the regulation of rates is one of the first forms in which it is asserted." *Block v. Hirsh*, 254 U.S. at 157. The highest courts of Massachusetts, New Jersey, New York, California, and Maryland have reached similar conclusions.[32]

The history of judicial approval of rent control provides compelling precedent for San Jose's decision to protect "hardship" tenants. Nonetheless, appellants contend that considerations of tenant hardship in determining rent

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funding has been substantially reduced, San Jose, like other California cities, is caught between Scylla and Charybdis. Fortunately, the Constitution is accommodating. "The problems of government are practical ones and may justify, if they do not require, rough accommodations—illogical, it may be, and unscientific." *Metropolis Theatre Co. v. City of Chicago*, 228 U.S. 61, 69-70 (1913).

[32] *Marshall House v. Rent Review & Grievance Bd.*, 357 Mass. 709, 260 N.E.2d 200 (1970); *Inganamort v. Borough of Fort Lee*, 62 N.J. 521, 303 A.2d 298 (1973); *Felner v. Office of Rent Control*, 27 N.Y.2d 692, 314 N.Y.S.2d 11, 262 N.E.2d 271 (1970); *Birkenfeld v. City of Berkeley*, 17 Cal. 3d 129, 130 Cal. Rptr. 465, 550 P.2d 1001 (1976); *Westchester West v. Montgomery County*, 276 Md. 448, 348 A.2d 856 (1975).

increases does not substantially advance the public interest. The public purpose of rent control is two-fold: to avoid hardship caused by excessive rent increases, while also guaranteeing a fair return to the landlord. In this context, San Jose's decision to temper rent increases so as to avoid hardship provides a perfect fit between means and ends. This is particularly true with the San Jose law because of the limited range of rent increases which are subject to mitigation. Only fifth-tier increases which are, by design, beyond the amount necessary to provide landlords with a constitutional fair return, can be affected by hardship concerns.[33] Since the first four tiers of rent increases authorized by appellee are already greater than most other rent control laws, any additional rent increase has a propensity to be excessive.

Appellants' amici go to great lengths attempting to establish the disutility and lack of public purpose of rent control in general, subjecting it to heightened scrutiny along the way. Not only are their political-economic attacks disputed,[34] they are irrelevant to the analysis. This Court has rejected the notion that, under the takings clause, "courts 'have a license to judge the effectiveness of legislation' or that courts are to undertake 'least restrictive alternative' analysis in deciding whether a state regulatory scheme is designed to remedy a public harm or is instead intended to provide private benefits." *Keystone*, 107 S. Ct. at 1243 n.16. This is especially true here because, as the Court observed in *Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968), "neither law nor economics has yet devised generally accepted standards for the evaluation of rate-making orders."

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[34] *See, e.g.*, Baar, *Facts and Fallacies in the Rental Housing Market*, Western City, Vol. 62, no. 9, p. 47 (Sept. 1986) (multi-family housing construction in rent control communities exceeds that in communities without rent control); Gilderbloom, *ante*, (rent controls do not deter new construction or housing maintenance); Harbridge House Inc., *A Study of Rent and Eviction Controls in the Commonwealth of Massachusetts*, p. ES-2 (1974) ("statistical evidence analyzed in this study indicates that there is no sound justification for the repeal of [rent control]. None of the available data demonstrates that rent control harms more people than it helps, or that it significantly impairs the supply of rental housing"); Marcuse, *The Uses and Limits of Rent Regulation* (A Report to Division of Housing and Community Renewal, State of New York, 1986) (rent control does not deter new construction; abolition of rent control would drive the poor out of New York City); Weitzman, *Economics and Rent Regulation: A Call for a New Perspective*,

D. The Tenant Hardship Provision Does Not Cause Appellants To Impermissibly Bear A Public Burden.

The just compensation clause is "designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *First Lutheran Church*, 55 U.S.L.W. at 4785, (citing *Armstrong v. United States*, 364 U.S. 40, 49 (1960)). Appellants seize upon this time-honored principle and argue that they may not be required to bear the burden of avoiding hardship and displacement of low-income tenants. Their analytical model is defective, however, for the "public burden" formulation is the conclusion drawn from a finding of an uncompensated taking.

As with all price control, rent control particularly burdens those whose prices are controlled. Indeed, land-use regulation generally bears more heavily on some owners than others. *Kirby Forest Industries v. United States*, 467 U.S. at 14. But that cannot be enough to trigger the requirement of just compensation. Rather, an individual is burdened in the Fifth

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13 Rev. Law & Social Change 975, 976 (1984) ("basic supply and demand model is inadequate for an understanding of the residential rental housing market . . . there is little empirical data to support many of the economic criticisms made about the new generation of rent regulations"). *See generally*, Nieback, *The Rent Control Debate* (1985).

Amendment sense only when a possessory taking or the elements of a regulatory taking (i.e., severe interference with a property owner's investment backed expectations) are otherwise present.

Any contrary rule would literally disable government. If, under the takings clause, burdens and benefits had to be precisely apportioned, most regulatory schemes would fall. As this Court stated in *Penn Central*, the fact that a law has a "more severe impact on some landowners than on others," 430 U.S. at 133-34, does not make it arbitrary, discriminatory, or isolated in its application. The fact that the law is part of a "comprehensive plan," *id.* at 132, "provides assurances against arbitrariness." *Id.* at 135 n. 32.

Nor does it matter that there is no exact reciprocity between the public benefits and the (hypothetical) burdens on appellants. "The Takings Clause has never been read to require the States or the courts to calculate whether a specific individual has suffered burdens . . . in excess of the benefits received." *Keystone*, 107 S. Ct. at 1245 n. 21. *See also Connolly v. Pension Benefit Guarantee Corp.*, ___ U.S. ___, 106 S. Ct. 1018 (1986); *Gateway Apartments, Inc. v. Nutley*, 605 F. Supp. 1161, 1167-68 (D.N.J., 1985).

In the final analysis, determination of excessive burden "necessarily requires a weighing of private and public interests." *Agins v. Tiburon*, 447 U.S. at 261. The "public interest" half of the equation has been subject to exacting scrutiny in this case. But demonstration of any "private burden" (i.e., quantitative effect of the ordinance on appellants), has been missing. This is critical because even a marginal public interest will satisfy *Agins* if there is *de minimus* private burden.[35]

In short, appellants' complaint is no different than with any other economic regulation. As this Court stated in an are irrelevant to the analysis. This Court has rejected the notion that, under the takings clause, "courts 'have a license to judge the effectiveness of legislation' or that courts are to undertake 'least restrictive alternative' analysis in deciding whether a state regulatory scheme is designed to remedy a public harm or is instead intended to provide private benefits." *Keystone*, 107 S. Ct. at 1243 n.16. This is especially true here because, as the Court observed in *Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968), "neither law nor economics has yet devised generally accepted standards for the evaluation of rate-making orders."

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[35] *See Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 245 (1978); *El Paso v. Simmons*, 379 U.S. 497, 516-17 (1985).

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As with all price control, rent control particularly burdens those whose prices are controlled. Indeed, land-use regulation generally bears more heavily on some owners than others. *Kirby Forest Industries v. United States*, 467 U.S. at 14. But that cannot be enough to trigger the requirement of just compensation. Rather, an individual is burdened in the Fifth Amendment sense only when a possessory taking or the elements of a regulatory taking (i.e., severe interference with a property owner's investment backed expectations) are otherwise present.

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In short, appellants' complaint is no different than with any other economic regulation. As this Court stated in an earlier rent control case: "A member of the class which is regulated may suffer economic losses not shared by others. His property may lose utility and depreciate in value as a consequence of regulation. Bu that has never been a barrier to the exercise of the police power." *Bowles v. Willingham*, 321 U.S. at 518.

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E. Appellants Ignore The Required Economic Analysis.

Appellants fail to establish the critical quantitative elements of a takings claim, namely that a taking occurs only where the law "makes it impossible for petitioners to profitably engage in their business, or [where] there has been undue interference with their investment-backed expectations." *Keystone*, 107 S. Ct. at 1242. Instead of proof, appellants rely on tautology. They assert that the tenant hardship provision operates so as to "deprive[] property owners of the reasonable rents that they would [otherwise] receive." AB at 23. This is boot-strapping; first arguing that fair return is defined by the San Jose ordinance absent Section 17.23.440(C), and then arguing that any factor which reduces rents below that level *ipso facto* deprives landlords of a fair return.

Appellants' approach suffers from two infirmities. First, it requires this Court to isolate and focus on the incremental rent potentially affected by the tenant hardship provision. Yet, as this Court has cautioned, "[t]aking jurisprudence does not divide a single parcel into discrete segments and attempt to determine whether rights in a particular segment have been entirely abrogated". *Penn Central*, 438 U.S. at 130. This unitary approach was reaffirmed just last term in *Keystone*. 107 S. Ct. at 1249-50.

Second, appellants confuse the generosity of the San Jose law with constitutional requirements in rent control cases. When analyzing fair return standards, courts often inquire whether "the rent allowed is reasonable." *Block v. Hirsh*, 256 U.S. at 158. *See Birkenfeld*, 17 Cal. 3d at 156, 550 P.2d at

1027, 130 Cal. Rptr. at 491 (rent setting mechanisms must provide a "just and reasonable return" to the landlord). Reasonableness in this context derives from the broader requirement that a law not be "unconstitutionally confiscatory," as that term is used in rate regulation cases. *See, e.g., Birkenfeld*, 17 Cal. 3d at 165, 550 P.2d at 1027, 130 Cal. Rptr. at 491 (citing *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575 (1942)).

Thus, a taking can be shown only if the San Jose law, as a whole, operates so as to reduce appellants' return below constitutional minimums. But, appellants cannot meet the required showing for two reasons: their case is devoid of facts, and the San Jose law, on its face, guarantees a fair return even where that may cause possible tenant hardship.

III.

PRICE REGULATION BASED IN PART ON ECONOMIC HARDSHIP CONCERNS DOES NOT VIOLATE THE DUE PROCESS CLAUSE

As with their takings challenge, appellants' due process argument focuses on methodology rather than result. They contend that the San Jose law is arbitrary, even if it has no demonstrable economic impact on them. Unless appellants are challenging the rational basis test of *Nebbia v. New York*, 291 U.S. at 537, their claim of arbitrariness necessarily rests on analysis of the law's impact.[36] Accordingly, in assessing rate orders, this Court uniformly focuses on the result, not the method. *FPC v. Hope Natural Gas*, 320 U.S. 591, 602 (1943). *See also FPC v. Natural Gas Pipeline Co.*, 315 U.S.

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[36] As used in the rational basis test, there is nothing "arbitrary" about the San Jose tenant hardship provision. It specifically targets relief from fifth-tier rent increases to those cases where the increase would be excessive "under the circumstances." Section 5703.28(c). *See supra*, Section IIC. Indeed, it is not obvious how the ordinance would be less arbitrary (or appellants better off) if fifth-tier rent increases were disallowed altogether.

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at 586 ("Constitution does not bind rate-making bodies to the service of any single formula").

The requirements of due process are satisfied so long as appellants' rent levels are within "the broad zone of reasonableness." *Permian Basin Area Rate Cases,* 390 U.S. at 770. However, appellants attempt to define reasonable rate based solely on their own economic need. Yet, in programs to safeguard the supply of affordable housing and avoid displacement, concerns for tenant hardship surely become an element of reasonableness. Thus, impact considerations are often contained in land use regulations, such as condominium conversion ordinances. *See Troy v. Renna,* 727 F.2d 287 (3d Cir. 1984).[37] Since "investors interest provide only one of the variables in the constitutional calculus of reasonableness," *Permian Basin,* 390 U.S. at 769, the fact that a number of competing interests, including that of the "consumer," are considered is irrelevant. *Id.* at 770. "[The] choice among rate structures involves difficult and important questions of economic supply and distributional fairness. The State's concern that rates be fair and efficient represents a clear and substantial governmental interest." *Central Hudson Gas v. Public Service Comm'n,* 447 U.S. 557, 569 (1980).

To support their due process claim, appellants rely on *Property Owners Ass'n v. North Bergen TP,* 74 N.J. 327, 378 A.2d 25 (1977), a case which they claim is at odds with the decision below. There, the court held that the effect of a blanket rent freeze on units occupied by low-income senior tenants, irrespective of landlord expenses, could result in confiscatory rates of return. 74 N.J. at 336, 378 A.2d at 29. The court did not dispute the "unquestionably laudatory" public interest, *id.* at 332, 378 A.2d at 27, in providing special housing relief for needy tenants.[38] Yet, the court was concerned that because of its rigid application, the ordinance could reduce a landlord's earnings below the constitutional minimum of a "just and reasonable rate of return." *Id.* at 335, 378 A.2d at 29.

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[37] Similar conclusions have been reached elsewhere. *See Gilliead v. Fordham Hills Owners' Corp.,* 601 F.Supp. 531 (S.D.N.Y. 1985); *Reiner-Kaiser Assoc. v. McConnachie,* 104 Misc. 2d 750, 429 N.Y.S.2d 343 (1979). *See also Cusack v. City of Chicago,* 242 U.S. 520 (1971).

Similarly, in *Helmsley v. Borough of Fort Lee,* 78 N.J. 200, 394 A.2d 65 (1978), the New Jersey Supreme Court again invalidated a rent control law because of a rigid ceiling on rent increases, holding that it "virtually guaranteed that a landlord's income would fall below the minimum acceptable [constitutional] level." *Id.* at 226, 394 A.2d at 77.[39]

In contrast, the court in *Parrino v. Lindsay* sustained the New York Senior Citizen Rent Increase Exemption Law. The court rejected takings, due process, and equal protection challenges to the 17 month freeze on rents of low-income seniors. A six-month extension of the freeze was likewise upheld in *903 Park Avenue Corp. v. City Rent Agency,* 39 App. Div. 2d 694, 332 N.Y.S.2d 522, *rev'd other grounds,* 31 N.Y.2d 330, 338 N.Y.S.2d 901, 291 N.E.2d 141 (1972). But an unlimited extension was invalidated in *Hirschel v. City of New York,* 117 Misc. 2d 190, 460 N.Y.S.2d 438 (1983).

This latter case is significant because it, like *North Bergen,* teaches that constitutional inquiry into differential rent controls for low-income tenants requires economic analysis of the law's effects. In *Hirschel*, the court based its holding on the fact that the landlord had lost in excess of $15,000 in the first two years of the law's operation, and "this deficit will continue to grow annually and will never be recovered." *Id.* at 193, 460 N.Y.S.2d at 440. As in *North Bergen*, and *Helmsley*, the law was rigid in application and incapable of tempering adverse economic effects on the landlord. The law was confiscatory because it deprived the landlord of a fair return.

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[38] *See id.* at 335, 378 A.2d at 29 ("[t]hat appropriate legislative action may be taken to ameliorate the financial problems of senior citizens is indisputable").

[39] Apparently, New Jersey courts impose no requirement similar to this Court's that taking claims must be predicated on specific applications of challenged laws. Indeed, in *Helmsley,* despite massive economic data in the record, the court lamented: "One troublesome consequence of the procedural posture [in this case] is that we must reach general conclusions about all apartments in Fort Lee." *Id.* at 208, 394 A.2d at 69. It is doubtful whether either *North Bergen* or *Helmsley* would be justiciable in federal courts. The instant case suffers from the same procedural defect (*see ante,* Section I), but does not even have the benefit of a factual record as did the New Jersey cases.

The San Jose ordinance suffers from none of these infirmities. Appellants are entitled to four automatic levels of rent increase, sufficient to generate a fair return and meet all constitutional requirements. In each case, the increase is granted without consideration of tenant hardship. That becomes relevant only when the landlord seeks a bonus rent increase based on other factors. This is in stark contrast to the schemes disapproved in *North Bergen* and *Hirschel*, where rent increases were denied despite their inevitable effect on the landlord's ability to earn a fair return, an effect established in the record in each case. Here, appellants cannot colorably claim that the hardship provision results in confiscatory rents. See JS at A-6 n.6.

IV.

NEITHER LANDLORDS IN GENERAL, NOR THESE SPECIFIC APPELLANTS, HAVE BEEN SUBJECTED TO ARBITRARY OR INVIDIOUS DISCRIMINATION

In economic regulation cases, this Court applies the "rational basis test" to determine compliance with equal protection principles. *Dandridge v. Williams*, 397 U.S. 471 (1970). So long as there are "plausible reasons" for legislative action, judicial "inquiry is at an end." *U.S. Railroad Retirement Board v. Fritz*, 449 U.S. 166, 179 (1980). *Fritz* underscores the latitude governments have in classifying to achieve their goals. There, Congress had created four categories of railroad employees for purposes of determining retirement benefits. Windfall benefits were granted to some annuitants, but not others, depending on tenure and date of employment, and current connection with the industry. Because the windfall benefits were not constitutionally required, Congress could distribute them unequally, other than in a "patently arbitrary or irrational way." *Id.* at 177.

This case is similar. The bonus rent increases are not constitutionally required, and are likely insignificant when compared to the benefits at stake in *Fritz*. Any differential treatment is rationally related to the purpose of the law. *Parrino v. Lindsay; See* Note, *Rent Control for the Elderly with Low Incomes*, 51 B.U.L. Rev. 690, 691 (1971). The same conclusion has been reached in similar cases. *Moore v. Fowinkle*, 512 F.2d 629, 631 (6th Cir. 1975); *Sidberry v. Koch*, 539 F. Supp. 413, 419 (S.D.N.Y. 1982); *Rodriguez v. Towers Apartments, Inc.*, 416 F. Supp. 304, 307 n.7 (D.P.R. 1976); *Fenner v. Bruce Manor, Inc.*, 409 F. Supp. 1332, 1346 (D.Md. 1976); *Farrell v. Drew*, 19 N.Y.2d 486, 492, 281 N.Y.S.2d 1, 5, 227 N.E.2d 824, 827 (1967); *Ballard v. Rockville Centre Housing Authority*; *Frischman v. Durand*.

CONCLUSION

For the foregoing reasons, amici respectfully request that this Court either dismiss the appeal for lack of a properly presented federal question, or, in the alternative, affirm the decision of the California Supreme Court.

Respectfully submitted,

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PROOF OF SERVICE BY MAIL

State of California

ss.

County of Los Angeles

I, the undersigned, say: I am and was at all times herein mentioned, a citizen of the United States and a resident of the County of Los Angeles, over the age of eighteen (18) years and not a party to the within action or proceeding; that my business address is 11333 Iowa Avenue, Los Angeles, California 90025; that on July 31, 1987, I served the within *Brief of Amicus Curiae* in said action or proceeding by depositing true copies thereof, enclosed in a sealed envelope with postage thereon fully prepaid, in the United States mail at Los Angeles, California, addressed as follows:

Clerk, United States
Supreme Court
One First Street, N.W.
Washington, D.C. 20543
(Original and forty copies)

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Joan R. Gallo,
City Attorney
Office of the City Attorney
151 West Mission Street
San Jose, California 95110
(3 copies)

I declare under penalty of perjury that the foregoing is true and correct. Executed on July 31, 1987, at Los Angeles, California.

Siri Ved K. Khalsa
(Original signed)

AMICUS CURIAE

BRIEF

(21)

Supreme Court, U.S.
FILED
JUL 31 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-753

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

◆

RICHARD PENNELL and
TRI-COUNTY APARTMENT HOUSE OWNERS ASSOCIATION,

Appellants,

—vs.—

CITY OF SAN JOSE and
CITY COUNCIL OF THE CITY OF SAN JOSE,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF CALIFORNIA

BRIEF *AMICUS CURIAE* OF THE CENTER FOR CONSTITUTIONAL RIGHTS IN SUPPORT OF APPELLEES CITY OF SAN JOSE AND CITY COUNCIL OF THE CITY OF SAN JOSE

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Amicus Curiae

66pp

No. 86-753

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OCTOBER TERM, 1986

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CITY OF SAN JOSE and CITY COUNCIL
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Appellees.

ON APPEAL FROM THE SUPREME COURT
OF THE STATE OF CALIFORNIA

Brief Amicus Curiae of the Center for Constitutional Rights In Support of Appellees City of San Jose and City Council of the City of San Jose.

CONSENT OF PARTIES

Amicus Curiae has filed this brief with the consent of the Appellants and the Appellees. Letters of consent have been filed with the clerk of this Court.

INTEREST OF AMICUS CURIAE

The Center for Constitutional Rights was created in 1966 by lawyers who were active in the civil rights movement and the struggle of women and ethnic minorities in the United States for true equality. CCR attorneys have been involved in cases concerning voting rights, community control of schools, fair housing, employment discrimination, jury composition, and international human rights. Through litigation and public education CCR has worked to make meaningful the constitutional statutory, and international rights of women, Blacks, Puerto Rican, Native Americans, Asians, and Chicanos.

CCR is of the belief and has argued herein that the San Jose Ordinance which has been challenged in this litigation meets constitutional standards, properly balances the interests of landlords and tenants, and will stabilize the housing crisis experienced by that municipality.

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INTRODUCTORY STATEMENT OF THE CASE AND SUMMARY OF ARGUMENT

In 1979, the city of San Jose, California, enacted the Rental Dispute Mediation and Arbitration Ordinance (hereinafter "Ordinance"), the overall purpose of which was to respond to the city's "growing shortage of and an increasing demand for housing." Section 5701.2. The city found that this circumstance, "coupled with increasing inflation, the rising cost of developing new housing, and other factors... put substantial upward pressure on residential rents." Id.

The Ordinance was enacted to alleviate needs created by the housing crisis; prevent excessive and unreasonable rents; alleviate the hardship of individual tenants; and assure landlords a fair and reasonable return. Section 5701.2 These ends are to be accomplished by allowing landlords an automatic increase up to 8% (Section 5703.2), and providing a mechanism to pass through costs due to capital improvement, maintenance and rehabilitation (Section 5703.28(a)), or debt service (Section 5703.28(b).

In addition to the increases allowed by the first two provisions, an additional mechanism was established in which a hearing officer would, after considering seven factors[1], decide whether any additional increase is warranted.

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[1] The seven factors to be considered by the hearing officer include: rental history; past increases; landlord's response to Proposition 13 savings; maintenance and repairs; existing market value of similar housing; evidence of any landlord hardship; and evidence of any increase over and above those allowed by Section 5703.2; 5703.28(a) and 5703.28(b) as causing hardship to the tenant. (See Section 5703.28(c)).

If, on balance, the hearing officer determines that the proposed increase under Section 5703.28(c) imposes a severe financial hardship to the affected tenant, he may order that such excess, or portion thereof, be disallowed (Section 5703.29).

Appellants Pennell and the Tri-County Apartment House Owners Association ("Appellants") brought suit in the California courts claiming that Section 5703.28(c) and 5703.29 (the "tenant hardship provision") of the Ordinance were facially unconstitutional. Two lower courts agreed that the Ordinance was facially unconstitutional, however, these judgments were reversed by the California Supreme Court. That court found that under the Ordinance "all landlords are guaranteed a generous 8% rental increase each year as a matter of right, regardless of the hardship thereby imposed on any individual tenant." Pennell v. City of San Jose, 42 Cal. 3d 365, 374, 228 Cal. Rptr. 726 (1986). (emphasis in original) Because there did not exist a factual context in which to evaluate whether the tenant hardship factor would reduce an affected landlord's otherwise allowable rent increase, and... consequently create a disparity that could be characterized as arbitrary or grossly unfair, the court concluded that "an attack on the Ordinance's tenant hardship provision must await a challenge to the Ordinance as applied to a particular landlord and a particular tenant." Id.

In this Court, appellants contend that the Ordinance, in particular the tenant hardship provision, violates due process and equal protection, and is in violation of the takings clause of the Fifth Amendment.

Below, amicus will demonstrate that the arguments of the appellant must be rejected.

The tenant hardship provision of the San Jose Ordinance does not constitute a taking requiring just compensation. Since the ordinance explicitly provides that every landlord receive a fair return on his investment, the hardship provision could never override a landlord's right to a constitutionally-mandated return. Nor does the Ordinance constitute a physical taking. Its' provisions do not significantly abridge any of the landlord's bundle of rights associated with property ownership. Landlords are still able to use, exclude, transfer, modify and build on their property without interference from the city. Since the ordinance only prevents the imposition of exorbitant rental increases, it does not affect any rights so essential to ownership as to reduce significantly the economic value of the property.

The Ordinance and the tenant hardship provision substantially advance a legitimate state interest and benefit landlords and tenants alike. This Court has consistently affirmed that states and municipalities have broad power to regulate housing conditions due to the importance of housing in everyday life and are best placed to understand and address particular housing problems within their jurisdictions. Because the Ordinance helps to keep housing within the city affordable, landlords will benefit from a large population of renters and low vacancy rates. Therefore, any "burden" that some landlords may suffer because they are prohibited from charging exorbitant rents is more than offset by the benefit to the

general public and does not constitute a taking requiring compensation.

Neither does the Ordinance violate due process. The regulation is reasonably related to the purpose of eliminating excessive rents for tenants and providing landlords with a fair return. The tenant hardship provision, far from precluding a fair return, does not even preclude a maximum return. It operates as a balancing factor, among others, to assess rent over and above a fair return. Appellants' argument that the only "reasonable" return is what landlords could charge in an unregulated market, is, in essence, an argument against regulation in general - the constitutionality of which has long been settled.

Rent regulation, as a form of price control, is not necessarily constitutionally infirm under an equal protection analysis merely because it reduces the value of property and a member of a regulated class suffers economic losses not shared by others. The "welfare" burden or a "private bearing of public burdens" analysis, offered by appellants, presupposes that an unreasonable rate of return has been found. The tenant hardship provision does not reduce rents below a reasonable level and therefore the applicability of such an analysis as to it, is misplaced. A regulation, imposing a non-confiscatory burden and requiring the use of assets for the benefit of the public welfare, has been consistently held to be valid economic regulation, within the wide discretion of the legislative branch, and not violative of equal protection.

I. THE CALIFORNIA SUPREME COURT PROPERLY HELD THAT THE TENANT HARDSHIP PROVISION OF THE SAN JOSE RENT CONTROL ORDINANCE DOES NOT CONSTITUTE A TAKING BECAUSE IT DOES NOT DEPRIVE A LANDLORD OF A REASONABLE RETURN AND IT SUBSTANTIALLY ADVANCES A LEGITIMATE PUBLIC INTEREST

This Court has traditionally employed an ad hoc, factual approach to evaluating challenges to governmental action under the takings clause. Bowen v. Gillard, 55 U.S.L.W. 5079, 5084 (U.S. June 23, 1987) quoting Connolly v. Pension Benefit Guaranty Corp., 475 U.S. 211, 224 (1986). Such an approach has been necessary due to the speculative nature of land development and the unique circumstances giving municipalities reason to regulate in the public interest. In reaching a decision as to whether justice and fairness dictate that compensation must be granted, the Court has looked at the extent to which the regulation affects economic interests, the degree of interference with investment-backed expectations and the overall character of the governmental action. Penn Central Transportation Co. v. City of New York, 438 U.S. 104, 124 (1978). See also, Keystone Bituminous Coal Assn. v. DeBenedictis, 107 S.Ct. U.S. 1232, 1247 (1987); Kaiser Aetna v. United States, 444 U.S. 164, 175 (1979).

The purpose of the San Jose Rent Control Ordinance is to prevent tenants from being subjected to excessive rents as well as to insure that landlords receive a fair return on their investment. Section 5701.2; Appellant's Jurisdictional Statement at 4.

The "fair return" guarantee is designed to encourage investment and growth in the rental market in order to generate affordable housing. The California Court of Appeals has recognized that one of the purposes of rent control is to permit an efficient

landlord to pay all of his actual and reasonable expenses, and to receive a fair profit. Cotati Alliance for Better Housing v. Cotati, 148 Cal. App. 3d 280, 284 (Cal. Ct. App., 1983), quoting Birkenfeld v. City of Berkeley, 17 Cal. 3d 129, 165, 130 Ca. Rptr. 465, 550 P.2d 1001 (1976). (1976).

Appellants Pennell and the Tri-County Apartment House Owners Association seek to convince this Court that Section 5703.28(c) of the San Jose Ordinance deprives landlords of a fair market return. In attempting to do so, appellants chose to ignore the Ordinance's other provisions which 1) grant an automatic 8% increases to all landlords regardless of hardship imposed on individual tenants (5703.2); 2) allow landlords to pass through costs of capital improvements, increased costs of maintenance and operation or costs of rehabilitation plus 5% in their rental increases (5703.28(a)); and 3) provide that increased costs of debt service be deemed reasonable in determining what rent a landlord may charge (5703.28(b)).

It is only after these three provisions have been exhausted and a landlord still insists that he be able to impose higher increases than these criteria indicate are reasonable, that the Ordinance allows a hearing officer or arbitrator to consider, weigh and balance the tenant hardship provision with six other cost factors of operation. Since the hardship provision alone could never act to override a landlord's constitutionally protected right to operate his building at a profit, the tenant hardship provision does not adversely affect a landlord's economic rights so as to constitute a taking. This was essentially the reasoning of the

California Supreme Court. Pennell v. City of San Jose, 42 Cal.3d 365, 374 (1986); Appellant's Jurisdictional Statement at A-5.

Appellants claim that the Ordinance interferes with their ability to take advantage of San Jose's tight housing market to charge exorbitant rents. Indeed, it does. However, whatever "diminution in value" this may cause, the landlords' claim to such increases is not constitutionally mandated. As Justice Holmes once explained:

> "Government could hardly go on if to some extent values incident to property could not be diminished without paying for every such change in the general law." Pennsylvania Coal Co. v. Mahon, 260 U.S. 393, 413 (1922).

This Court has held that a diminution in value alone will not be of sufficient economic impact to constitute a taking as long as a fair profit can be obtained. Penn Central Transportation

Co. v. New York, 438 U.S. at 132. The Court has been particularly reluctant to find a compensable taking due to alleged diminution in value based on anticipated, speculative gain. See Andrus v. Allard, 444 U.S. 51, 66 (1979) ("Loss of future profits - unaccompanied by any physical property restriction - provides a slender reed upon which to rest a takings claim").

At this juncture, the appellants are free to impose an 8% increase and seek review with a hearing officer to determine the amount of increase above 8% that they feel is reasonable in light of housing market conditions. This hearing process provides each landlord with an individualized factual determination to assure that no owner will be economically disadvantaged and unable to secure a just return on his investment. Because of this process allowing for an

individualized determination, it cannot be said that the impact of a general rent control regulation has had such an adverse economic impact on appellants so as to violate the provisions of the Fifth and Fourteenth amendments.[2]

In evaluating the impact of a regulation of investment-backed expectations, this Court has stringently avoided relying upon "unilateral expectations or an abstract need." Ruckleshaus v. Monsanto Co., 467 U.S. 986, 1006 (1984), quoting Webb's Fabulous

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[2] This Court has found that officers of regulatory agencies "must be free within limitations imposed by pertinent constitutional and statutory commands, to devise methods of regulation capable of equitably reconciling diverse and conflicting interests." In Re Permian Basin Area Rate Cases, 390 U.S. 747, 767 (1968). Since the Ordinance is "not required to adopt as just and reasonable any particular rate level... courts are without authority to set aside any rate... within the 'zone of reasonableness'" Id.

Pharmacies v. Beckwith, 449 U.S.155, 161 (1980). Of crucial importance in such an analysis is whether the restriction would have been foreseen due to the nature of the commodity or whether "such restrictions are burdens we all must bear in exchange for living and doing business in a civilized community." Andrus v. Allard, 444 U.S. at 67 (1979), quoting Pennsylvania Coal Co. v. Mahon, 260 U.S. at 422 (1922) (Brandeis, J., dissenting); see also Ruckleshaus v. Monsanto Co., 467 U.S. at 1008 ("pesticide sale and use has long been the source of public concern and the subject of government regulation").

There is no doubt that housing is a necessity of life. Over 200 municipalities have enacted legislation regulating rental units to ensure access and preserve the health, safety and welfare of the community. See Note,

Emergency Tenant Protection in New York: Ten Years of Rent Stabilization, 7 Fordham Urb. L.Rev. 305 (1979). Rent control is not a new idea, particularly in areas in which housing is in short supply and high demand. Nor is rent control enacted in a vacuum. Public hearings and debate usually precede its enactment in any city. For appellants to assert that San Jose's Ordinance was totally unforeseen and has changed their expectations regarding ownership of their property is merely an attempt to feign blindness to the significant housing shortage that has existed in that city.

Appellants also assert that the Ordinance acts as a physical taking because it curtails some of their "bundle of rights" associated with property ownership. This concept is generally thought to include the rights to use, exclude, transfer, modify and build. See, Stone, *Community, Home and Residential Tenants*, 134 U.Pa.L.Rev. 627, 648 (1986), quoting Becker, "The Moral Basis of Property Rights", in *Property*: Nomos XXII 69, 190 (J. Pennock and J. Chapman eds. 1980). However, this Court has carefully evaluated the circumstance of each case to determine whether a strand of this "bundle of rights is so essential to the use or economic value of a particular piece of property that a state-authorized limitation amounts to a taking. *Pruneyard Shopping Center v. Robins*, 447 U.S. 74, 75 (1980), *distinguishing Kaiser Aetna v. United States*, 444 U.S. 164 (1979).

This Court has held that the ability to continue present use constitutes an owner's primary expectation regarding property. *Penn Central Transportation Co. v. New York*, 438 U.S. at 136. Both courts and legislatures tend to favor

regulation that permits continued present use because it encourages stability and growth. This Ordinance presents no constitutional infirmity in this regard.

The Ordinance is designed to have a minimal impact on an owner's continued use by allowing for automatic rent increases and requiring hearings only in exceptional circumstance where the landlord and tenant disagree over the validity of increases over the mandated 8%. In no way does the Ordinance prohibit any present use, nor place restrictions on a landlord's ability to rent, transfer, modify or build. Because the Ordinance guarantees all landlords a fair return on their investment, an owner's right to obtain profit from his property is not adversely affected by the Ordinance.

This Court's holding that a fundamental element of the bundle of property rights is the right to exclude others, Kaiser Aetna v. United States, 444 U.S. at 180-181 is likewise not implicated by the Ordinance. The obvious examples of a state's interference with this right are physical takings of property. The Court has consequently invalidated an ordinance that authorized a permanent occupation of a landlord's property by a third party (Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419, 440 (1982) as well as an ordinance that required owners to grant public easements as a condition of land development (Nollan v. California Coastal Commission, 55 U.S.L.W. 5145 (U.S. June 23, 1987). Action by the respective cities in those cases affected rights so essential to ownership that the economic value of the property had been significantly reduced.

On the other hand, a regulatory program that does not destroy a major

portion of a property's value has never been found to be taking. See Keystone Bituminous Coal Assn. v. DeBenedictis, 107 S.Ct. 1232 (1987); First English Evangelical Lutheran Church of Glendale v. County of Los Angeles, 55 U.S.L.W. 4781, 4788 (U.S. June 9, 1987) (Stevens, J., dissenting); Hodel v. Virginia Surface Mining and Reclamation Assn., 452 U.S. 264, 296 (1981); Agins v. Tiburon, 447 U.S. 255, 260 (1980). The San Jose Ordinance does not affect a landlord's right to exclude merely because it prohibits him from charging excessive rents. Although a tenant's income may be one factor used to determine the reasonableness of a requested rental increase, there is nothing to suggest that this provision will unreasonably impair a landlord's ability to operate his building and receive a fair return on his investment.

Recently, this Court has held that "the condition for abridgement of property rights through the police power...(is the) substantial advancing of a legitimate state interest." Nollan v. California Coastal Commission, 55 U.S.L.W. at 5147. In that case property owners were forced to grant the city an easement as a condition to building on their property. However, in cases in which property rights have merely been impacted, but not restricted, the Court has been more willing to defer to the legislative determination as to the proper balance between public and private interests. See, e.g. Berman v. Parker, 348 U.S. 26, 32 (1954); Agins v. Tiburon, 447 U.S. at 260 (1980) ["A regulation will be deemed a taking if it does not substantially advance state interests or denies an owner economically viable use of his land"]. Indeed in Nollan, the

Court observed that "[w]e are inclined to be particularly careful about the adjective [substantial] where the actual conveyance of property is made a condition of a land use restriction." Nollan v. California Coastal Commission, 55 U.S.L.W. at 5149, (emphasis added).

The San Jose Ordinance is designed to reach an equitable accommodation of landlord-tenant interests through fact-sensitive determinations informed by a number of clearly determined economic factors so as to best promote stability in the housing market and encourage investment. It would clearly not be in the city's interests to force landlords into bankruptcy. The Ordinance therefore reflects the public's overall interest in insuring occupancy and return to landlords, and affordability and supply to tenants. There is no more economical and efficient way for the city to achieve these goals without having more of an impact on the private market.

This Court has consistently affirmed that states and municipalities have broad power to regulate housing conditions and the landlord-tenant relationship without paying compensation for all economic injuries that such regulation entails. See Heart of Atlanta Motel Inc. v. United States, 379 U.S. 241 (1969) (discrimination in places of public accommodation); Queenside Hills Co. v. Saxl, 328 U.S. 80 (1946) (fire regulation); Bowles v. Willingham, 321 U.S. 503 (1944) (rent control); Home Building and Loan Assn. v. Blaisdell, 290 U.S. 398 (1934) (mortgage moratorium); Block v. Hirsh, 256 U.S. 135 (1921) (rent control). See also, Judson, Defining Property Rights: The Constitutionality of Protecting Tenants from Condominium Conversion, 18 Harv. C.R.-C.L. L.Rev. 179, 209 (1983). Long

ago this Court recognized that the objective of insuring access to housing contained "all elements of a public interest justifying some degree of public control". Block v. Hirsh, 256 U.S. at 156. Because municipalities are in the best position to know the particular problems and concerns about housing within their own communities, the Court has found that their legislative judgments are entitled to great respect. Id. at 154.

The only limitation on a municipality's regulation in the public interest is that the purpose served must have a "public character". Ruckelshaus v. Monsanto Co., 467 U.S. at 1014. In Ruckelshaus, the Court observed that a "public purpose" need not provide benefits available to or enjoyed by all members of the public, or that the property taken be committed and open for use by the general public. Id. The "public character" requirement is designed to "bar the Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." Armstrong v. United States, 364 U.S. 40, 49 (1960). The separation of "public" from "private" burdens has never been an easy task, and the courts pay close attention to whether the property owners affected will share with other owners the benefits and burdens of the city's exercise of its police power. Agins v. Tiburon, 447 U.S. at 262 (1980).

The San Jose Ordinance is comprehensive in scope and in application will affect all private landlords within the city. It benefits landlords by allowing for automatic and approved increases. By prohibiting those few greedy landlords who may try to impose excessive rents,

the majority of landlords will benefit from the Ordinance's objectives to keep tenants within the city and maintain low vacancy rates. Every resident, landlord and tenant alike, will be hurt if the lack of affordable housing forced people to move from the city. A pattern of such decay and decline has been witnessed in far too many cities already and San Jose has taken preventative, well-thought-out steps to prevent this.

Given the nature of our economy, it is clear that "circumstances may so change in time... as to clothe with such a (public) interest what at other times... would be a matter of purely private concern." Keystone Bituminous Coal Assn. v. DeBenedictis, 107 S.Ct. at 1243 (1987), quoting Block v. Hirsh, 256 U.S. at 155. Although housing has always been an essential part of everyday living, a legislature needs flexibility to deal with problems that arise with its available housing stock. Since the San Jose Ordinance guarantees a fair return to landlords and serves the city's need to insure affordable housing for its tenants, the city has acted within the scope of its police power.

II. THE ORDINANCE SATISFIES THE REQUIREMENT OF DUE PROCESS AND EQUAL PROTECTION AS IT IS RATIONALLY RELATED TO THE PROPER PURPOSE OF PROTECTING AGAINST EXCESSIVE RENT AND ASSURES LANDLORDS A FAIR RETURN OF THEIR INVESTMENT

A. The Requirement Of Due Process Is Satisfied By The Ordinance.

Since 1934 it has been clear that a state is free to adopt whatever economic policy may be reasonably deemed to promote the public welfare, and may enforce that power by legislation adapted to that purpose. Nebbia v. People of the State of New York, 291 U.S. 502, 516 (1934). The requirements for due process are satisfied, therefore, if the legislative means are seen to have a real and substantial relation to the object of the legislation, and are neither arbitrary nor discriminatory. Pruneyard Shopping Center v. Robins, 447 U.S. at 84; Nebbia, 291 U.S. at 537. There is a traditional presumption by the Court of the constitutionality of economic regulations and, as such, the regulations will be upheld absent proof of arbitrariness or irrationality. Usery v. Turner Elkhorn Mining Co., 428 U.S. 1, 15 (1976).

To withstand due process scrutiny, land use regulations as well as price controls must further some rational legislative purpose. Moore v. City of East Cleveland, 433 U.S. 494, 498 n. 6 (1977); Euclid v. Ambler Realty Co., 272 U.S. 365 (1926).

Under this standard, once rationality and proper purpose are found, judicial inquiry stops, as courts do not sit as a "superlegislature" and are not authorized to second guess the wisdom of the policy adopted. Day-Brite Lighting, Inc. v. Missouri, 342 U.S. 421, 423 (1952). See also Ferguson v. Skrupa, 372 U.S. 726 (1963).

Therefore, in order to prove that the tenant hardship provision violates

due process, appellants must demonstrate that the provision has no rational relationship to any governmental interest. As argued below, appellant's claims in this regard are entirely unpersuasive.

1. The Ordinance Is Rationally Related to The Purpose of Assuring Landlords A Fair and Reasonable Return.

Appellants argue that the tenant hardship provision bears no rational relationship to the reasonableness of the landlord's rate of return (Appellant's Brief at 6). This contention, however, is based on an erroneous and misleading definition of what constitutes a "reasonable" return.

Appellants suggest that a "reasonable" return should be based upon a consideration of only the first six factors as enumerated in Section 5703.28(c), defining those factors as "objective" factors in determining the reasonableness of a rental increase (Appellant's Brief at 12). However, appellants in their formulation mistakenly equate a "fair" return with fair market *value*.[3]

The first six "objective" factors enumerated in §5703.28(c) are factors any landlord would consider in determining what the optimal fair rent of a particular unit would be when placed on an

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[3] *Black's Law Dictionary* (4th ed., 1951) defines fair market value as:

> "Fair market value" assumes agreement between owner willing but not obliged to sell for cash and buyer desirous but not compelled to purchase [citations omitted]. It means neither panic value, auction value, speculative value, nor a value fixed by depressed or inflated prices [citations omitted]. *It resides in estimate and determination of what is fair, economic, just and equitable under normal conditions [citations omitted]*.

Id. at 716 (emphasis added).

unregulated market (i.e. its "worth"). Therefore, appellants' argument reduces to a tautology: a demonstration by a landlord that he/she is able to receive market value for a unit means that anything less is not "reasonable."

In essence, appellants urge the Court to hold that the rate which landlords demonstrate they deserve, is the rate which the Constitution requires. That landlords would believe that such rents are "reasonable" is understandable; however this understanding goes far beyond what the Constitution mandates.

This Court has held that the fixing of just and reasonable rates involves a balancing of investor and consumer interests. *In Re Permian Basin Area Rate Cases*, 390 U.S. at 770; *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1943). Thus, a fair return does not imply a maximum return.

See Penn Central Transportation Co. v. City of New York, 438 U.S. at 124. In Penn Central, the Court deeemed "untenable" the contention that a "taking" was established by a showing that a party had been denied the ability to exploit a property interest, believed to have been available. Id. at 130. In unequivocal terms the Court found that "government may execute laws or programs that adversely affect recognized economic values." Id. at 124. A fair return has been defined as the assurance that a landlord recover all reasonable expenses and receive a fair profit. See Birkenfield v. City of Berkeley, 17 Cal. 3d at 165, 130 Cal. Rptr. a 491; Hutton Park Gardens v. Town Council, 68 N.J. 543, 350 A.2d 1 (1975).

Appellants' contentions can thus be seen as a thinly disguised argument that anything less than an optimal return is

"unreasonable." This is an attack, not on the tenant hardship provision per se, but rather an all-out declaration of war on regulation in general,[4] the constitutionality of which has long been settled. See e.g. Cities Service Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 179 (1950) (natural gas); Mayo v. Lakeland Highlands Canning Co., 309 U.S. 310 (1940) (citrus); Townsend v. Yeomans, 301 U.S. 441 (1937) (tobacco).

Further, facial invalidity of an ordinance is found only upon a showing that the regulation at issue facially precludes any possibility of a just and reasonable return. Cotati Alliance for Better Housing v. Cotati, 148 Cal. App.3d at 291, 195 Cal. Rptr. at 832. The San Jose Ordinance does not preclude a fair and reasonable return. Nor does the tenant hardship provision. The Ordinance guarantees the landlord the recovery of his reasonable costs and a fair profit. In addition, it allows the landlord to recover an optimal market rate upon a showing of factors indicating that he/she is not receiving the market value, and a finding that such rate will not create undue financial hardship for the affected tenant.

---

[4] What appellants attack indirectly, amici in support of appellants attack explicitly in general arguments against rent control, irrespective of the provisions of the ordinance at issue. See e.g. Amicus Curiae Briefs of the National Multi-Housing Council at 10-16; Competitive Enterprise Institute at 6-12; National Apartment Association and The California Apartment Association at 2-5; Washington Legal Foundation 11-17; National Association of Realtors at 6-11.

The tenant hardship provision, therefore, only operates to provide a balancing factor should the landlord wish to charge the market value for a unit.

Accordingly, the Ordinance and the tenant hardship provision, are not

facially confiscatory and are rationally related to the purpose of assuring the landlord a fair and reasonable return.

2. The Ordinance Is Rationally Related To The Purpose Of Protecting Tenants Against Excessive Rent.

Appellants argue that the tenant hardship provision does not rationally relate to protecting San Jose's asserted interest against unreasonable and excessive rent. First, they ground this contention on an inapplicable definition of "excessive" as any rent above market value, as shown above. Second, appellants miscontrue the interests sought to be protected by the tenant hardship provision, and the Ordinance as a whole. (Appellant's Brief at 12)

The Ordinance expressly states that its purpose is to protect tenants from "arbitrary, capricious or unreasonable rent increases," while permitting landlords "a fair and reasonable return." Thus the purpose of the Ordinance is expressly two-fold: the protection of the tenants' interest in having available, affordable housing, and the protection of the landlords' interest in receiving a fair profit after expenses.

In light of this clear statement of legislative purpose, appellants' construction of the "excessive rent" leg of the Ordinance's purpose misplaces the frame of reference from which the Ordinance is properly viewed. The Ordinance's purpose of preventing excessive rent serves a protective function for tenants, and is related to the city's interest in having affordable housing available for its renter population in the context of upward inflationary pressure. This is clearly proper public purpose. See Yakus v. United States, 321 U.S. 414 (1944) [Price-fixing to counter

inflationary pressure is constitutionally proper]. Appellants attempt to narrow this protective function of the Ordinance by interpreting it to protect tenants against the imposition of rents in excess of market value. However, even assuming that this is the sole purpose of the Ordinance, appellants' argument still fails for inconsistency. It is clear that the mandated 8% increase may well be, in certain circumstances, more than what the apartment is objectively worth and therefore "excessive" given appellants' construction. Yet appellants do not appear to have any constitutional objection when the 8% income mandated by the Ordinance works in their favor. Appellants thus wish to have it both ways. They find an 8% guaranteed increase a "fair" increase even if the apartment does not warrant it, but find it "unreasonable" if in their judgment, the apartment might warrant more.

It is obvious that the purposes of the Ordinance are separate purposes and are to be evaluated separately. The tenant hardship provision, in addition to assuring landlords a fair return, seeks to protect the renting public's interest in having housing which is not above their means. A provision which seeks to balance that interest with the landlords' interest to charge the rate which reflects the maximum value of a unit, is certainly rationally related to the purpose of protecting tenants against excessive rent increases.

B. The Ordinance Does Not Arbitrarily Select Landlords For A Species Of Taxation In Violation Of The Equal Protection Clause Of The Fourteenth Amendment.

A classification, not involving a "suspect" class or "fundamental right" will be constitutionally sustained provided it is rationally related to a legitimate state interest. New Orleans v. Dukes, 427 U.S. 297, 303 (1976). Such a test has been applied in an equal protection context regarding land-use regulation (Village of Belle Terre v. Boraas, 416 U.S. 1, 8 (1974)), as well as rent control (Marcus Brown Holding Co. v. Feldman, 256 U.S. 170, 198-99 (1921)). Further, price control is not constitutionally infirm if it reduces the value of property which is regulated, and a member of a regulated class suffers economic losses not shared by others. Bowles v. Willingham, 321 U.S. at 518.

Appellants attempt to assert an equal protection argument against the tenant hardship provision by recasting the purpose of the provision as a reduction of rents "below a reasonable level to alleviate hardship to individual tenants," thereby imposing a "welfare burden on individual landlords as a one-on-one subsidy." (Appellant's Brief at 14). This, appellants contend, "arbitrarily selects individual landlords for a species of taxation to subsidize the welfare of poor tenants" in violation of equal protection. (Appellant's Brief at 19).

First, as shown above, the tenant hardship provision does not reduce rents below a reasonable level. Second, subsidy _per_ _se_ is not constitutionally invalid. Even appellants concede that a return which provides a "subsidy" between fair return and full market return is

constitutionally proper (Appellant's Brief at 14). See also _Fisher v. City of Berkeley_, 37 Cal. 3d 644, 209 Cal. Rptr. 682, 693 P.2d 261 (1984). That is precisely what the Ordinance with the tenant hardship provision will provide at a minimum. As shown above, the Ordinance will even allow the possibility of a landlord receiving the full market value if no tenant hardship is found.

Appellants cite _Property Owners Association v. Township of North Bergen_, 74 N.J. 327, 378 A.2d 25 (1977), as primary authority for their contention that the tenant hardship provision constitutes a denial of equal protection. However, a clear reading of _North Bergen_ does not support appellants' argument.

In _North Bergen_, the ordinance at issue regulated rent increases at 5% per year maximum, with an additional 10% increase allowed for either capital improvement or landlord hardship, totalling an aggregate possible increase of 15%. Amendments to the ordinance were subsequently passed that, in effect, capped any increase for senior citizens at 10%. Thus in North Bergen, there was at least a 5% difference between what was adjudged in the ordinance itself to be a fair return, and the return allowed for senior citizens. The subsidy declared to be constitutionally infirm by the New Jersey Supreme Court was the difference between the fair return (up to 15%) and the 10% cap for senior citizens. It was this difference that was confiscatory.

The Ordinance at issue here suffers from no such infirmity. The difference in returns, if any, will lie between the fair return mandated by the Ordinance and the market value, which appellants concede is constitutionally proper.

Appellants (Appellant's Brief 23) and amici (see. e.g. Brief of National Multi-Housing Council at 22, Competitive Enterprise Institute at 3-4) rely heavily on a theory that the tenant hardship provision forces San Jose landlords to "bear public burdens which, in all fairness and justice, should be borne by the public as a whole," (quoting Armstrong v. United States, 364 U.S. at 49)and therefore is in contravention of the takings clause and equal protection. However, appellants and supporting amici turn this concept on its head.

Intrinsic to the applicability of this notion is the threshold finding of a taking. That is, the reason for forbidding an uncompensated taking is to preclude a private individual from having to shoulder a public burden without compensation. Agins v. Tiburon, 447 U.S. at 260-61. It follows, however, that if no taking is found, then ipso facto, the private individual is not being asked to bear a public burden alone.

Appellants thus assume what is to be proven. They attempt to reinterpret the purpose of the taking clause to mean that any regulation which allocates any burden, confiscatory or not, which requires individuals to use their assets for the benefit of others should automatically be deemed a taking. This formulation has been explicitly rejected by this Court. Connolly v. Pension Benefit Guaranty Corp., 475 U.S.at ___, 106 S.Ct. at 1025.

Appellants' argument also fails when seen in the context of equal protection. Given the propriety of governmental regulation, an economic regulation which results in some inequality will not violate the equal protection clause if "any state of facts may be conceived to

justify it." McGowan v. Maryland, 366 U.S. 420, 426 (1961). In the area of economic regulation, this Court has held that a state does not violate the equal protection clause even if the classification is imperfect, unequal, unscientific, illogical, or unwise. Dandridge v. Williams, 397 U.S. 471, 485 (1970).

It is noteworthy that the equal protection cases cited by the Amicus, Rent Stabilization Association for their contentions pre-date Nebbia v. New York, and its progeny which expanded the regulatory powers of legislatures. Modern cases have recognized that the states have a great deal of flexibility to deal with socio-economic problems and that courts must strongly allow governmental bodies to remedy ills one at a time. Geduldig v. Aiello, 417 U.S. 484 (1974); Jefferson v. Hackney, 406 U.S. 535 (1972); Dandridge v. Williams, 397

U.S. 471 (1970); Williamson v. Lee Optical, 348 U.S. 483, 489 (1955).

In fact appellants and supporting amici utilize arguments (and often cases) that are strongly reminiscent of the substantive due process arguments of the era in which regulations which curtailed the right to engage in a business or enter contracts were held violative of the Fourteenth Amendment. See e.g. New York State Ice Co. v. Liebman, 285 U.S. 262, 278 (1932). However, modern Court doctrine has held that the equal protection clause may not be used "as a vehicle for restating notions of substantive due process that have been repudiated." Kahn v. Shevin, 416 U.S. 351, 356, n.10 (1974).

The tenant hardship provision of the Ordinance does not compel a rate below fair return, does not require a confiscatory subsidization of tenants by

landlords, and is thus not violative of the equal protection clause.

C. Rent Regulation Does Not Cause Discrimination Against Low Income Tenants

Amici in support of appellants contend that the tenant hardship provision operates to create discrimination against low income tenants and is thus counterproductive to the stated purposes of the instant Ordinance. See e.g. Brief Amicus Curiae of the California Association of Realtors at 13. However, one of the articulated purposes of the Ordinance is to protect tenants against excessive rent increases which obviously includes in that protection, low-income tenants already residing in regulated housing. Thus, the tenant hardship provision is clearly related to that express purpose.

It is worth noting in addition that the tenant hardship provision does not permit a landlord to exclude or screen tenants based on income as supporting amici would have the Court believe.

California law expressly forbids an exclusionary policy based on occupation, age, race, or gender. Marina Point, Ltd. v. Wolfson, 30 Cal. 3d 721, 180 Cal. Rptr. 496, 640 P.2d 115 (1982). Being thus prohibited, a tenant's income cannot be used as a pretextual basis for his or her exclusion. In addition, under California law, all arbitrary discrimination by business establishments is prohibited, including the exclusion of children and families with children from rental housing. Wolfson, 30 Cal. 3d at 725. A landlord who would economically screen tenants in order to exclude all tenants unable to pay the full market value would also be acting unlawfully, since the tenant hardship provision is explicitly designed to protect such tenants. Consequently, the contention

that the Ordinance would permit this kind of discrimination is without merit.

Finally, supporting amici present the conceptually novel assertion that the tenant hardship provision is not rationally related to the purpose of alleviating needs created by San Jose's housing situation, as tenant hardship is created by "general social conditions" unrelated to the city's housing policies. Brief Amicus Curiae of The National Apartment Association and The California Apartment Association at 16.

Amici's contention that excessive rent increases are not related to tenant hardship and a severe housing shortage is somewhat farfetched. In any event, the Ordinance is not aimed at eliminating financial hardship in general, in which case a "general social condition" analysis would be at least colorable. The Ordinance seeks to protect only the citizens of San Jose in regard to the rental housing relationship.

As such, the Ordinance and the tenant hardship provision is directly related to the housing situation in San Jose, and the tenant hardship provision is directly related to the hardship a tenant may experience if confronted by excessive rent increases.

III. CONCLUSION

For the foregoing reasons, Amicus respectfully submits that the San Jose Ordinance is not constitutionally invalid. The judgment of the California Supreme Court should therefore be affirmed.

Respectfully submitted,

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* Counsel wishes to express his appreciation to Terri Pandolfi, second year law student at Brooklyn Law School; Chris K. Iijima, third year law student at New York Law School; and B. Mullings-Rosa, legal worker at the Center for Constitutional Rights. But for their assistance, this brief could not have been written.

AMICUS CURIAE

BRIEF

20

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No. 86-753

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UNITED STATES

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ASSOCIATION,

Appellants,

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CITY COUNCIL OF SAN JOSE,

Appellees.

On Appeal from the Supreme Court
of the State of California

BRIEF FOR AMICUS CURIAE NATIONAL HOUSING LAW PROJECT IN SUPPORT OF APPELLEES

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INTEREST OF AMICUS CURIAE

Since 1968, the National Housing Law Project, a California nonprofit corporation, has been a federally funded Legal Services support center which aids attorneys throughout the country who represent low-income clients with housing problems. In the course of its 18-year existence, the Project has developed broad and detailed knowledge of poor people's housing problems, of the history, purpose and intricacies of the federal and state housing laws, including rent control laws, and of the mechanisms needed to ensure that those laws are carried out. In this case, the Project's interest is in ensuring that the Court is as fully informed as possible about the legal background of rent control and fair return issues and that local governments retain flexibility to respond to their own housing problems. This brief is filed with the consent of all parties.

SUMMARY OF THE ARGUMENT

Appellants' arguments here rely
rimarily upon a single erroneous asser-
ion that fatally infects their entire
ase. Appellants repeatedly contend
hroughout their brief that the tenant
ardship provision of the San Jose
rdinance would operate to deny them
heir constitutional due under the "fair
eturn" doctrine. Because the applica-
ion of a compulsory hardship provision
n this fashion would obviously implicate
he due process clause under the "fair
eturn" doctrine, and arguably raise
elated problems under the takings
lause, appellants have attempted to
kirt the difficulties inherent in
roving these constitutional violations
n a specific factual record by exalting
his fundamentally inaccurate contention.

Appellants' view plainly does not
quare with the teachings of fair return

case law developed by this and other courts,[1] nor with the express terms of San Jose's ordinance, nor with any logical interpretation of that ordinance. Stripped of this constitutional dimension, appellants' claims are reduced to unripe attacks upon speculative deprivations of expected profits that have no statutory foundation. Ironically, the result of accepting appellants' theory would be decreased flexibility available to governments in exercising their police power. Most lawmakers would then prefer the less generous but facially invulnerable route of providing only the constitutional minimum. Appellants' misinterpretation of fair return law and San Jose's ordinance must be dismissed accordingly.

---

[1] Similarly, any and all attempts of appellants and amici to challenge the wisdom of rent control are rendered immaterial by this Court's substantive due process and taking cases, as well as by the rulings of the California Supreme Court and this Court in Fisher v. City of Berkeley, 37 Cal.3d 644, 693 P.2d 261 (1984), appeal on due process grounds dismissed for want of a substantial federal question, 471 U.S. 1124 (1985). In Fisher, this Court dismissed that portion of the appeal which raised facial due process and takings challenges to a Berkeley rent control law far more restrictive than that at issue here. An as applied challenge to the same ordinance on due process, equal protection, and takings grounds was rejected by the Ninth Circuit in Amberhill Properties v. City of Berkeley, 814 F.2d 1340 (9th Cir. 1987).

San Jose's legislature has here decided that, in administering one of its optional rent increase methods, it is appropriate to temper those extraordinarily generous provisions, always yielding at least the constitutional minimum, by simultaneously considering tenant hardship. Because the constitutional fair return guarantee is never impeded by the hardship factor, San Jose's fourth rent increase method is no more constitutionally vulnerable than any other regulatory restriction or price control that a business might oppose as cutting into potential profits. The court below correctly so held. There is no reason to disturb its judgment on this record.

First, the San Jose ordinance clearly guarantees landlords a fair return, so that any facial confiscation claim is thereby avoided. To hold otherwise would run contrary to the entire course of judicial analysis in the fair return area that has emphasized, absent extraordinary circumstances, the necessity of "as applied" review. See § I, infra.

Second, San Jose's ordinance does not unconstitutionally take appellants' property. This conclusion is true for several independent reasons, including the lack of a specific factual record, the absence of a protectable property interest, and the existence of both economically viable use and a sufficient nexus. See § II, infra.

Third, the ordinance survives deferential review under ordinary substantive due process standards. A contrary holding would render government powerless to employ the police power to condition some of the benefits flowing from a regulated activity, the operation of rental housing, upon consideration of some of the burdens created by that same activity. See § III, infra.

Fourth, the classification created by the operation of the fourth rent increase method satisfies ordinary equal protection review for reasons similar to those that satisfy due process requirements. See § IV, infra.

ARGUMENT

I. BY GUARANTEEING LANDLORDS A FAIR RETURN, THE SAN JOSE ORDINANCE IS NOT FACIALLY CONFISCATORY.

A. San Jose's Rent Control Law

San Jose's ordinance reflects a careful and unique design to provide an ective option for landlords to seek re than the constitutionally minimum quired fair return in certain cases. e ordinance's rent adjustment provisions go further than almost any other nicipal rent control law toward easing e inevitable tension between the ndlords' desire to recover a return as ose to that available in the unregulated market and local governments' jective to prevent excessive rents ile simultaneously providing the quisite fair return. Because it is fficiently flexible, the ordinance does t raise a significant fair return sue.[2]

Beyond the allowance for vacancy control, San Jose provides four different routes for a landlord seeking an individual rent adjustment. A landlord may raise rents to the highest amount allowable under any of the four methods. First, the ordinance provides an automatic entitlement to an 8-percent annual increase. San Jose, Cal., Ordinance No. 19696 (hereafter "Ord."), § 5703.2. An 8-percent annual increase thus serves as the absolute minimum that a landlord will receive. If that appears insufficient, the landlord may employ a second method, offering a 5-percent increase plus specified passthrough costs (including capital improvements, increased maintenance and operation costs, and costs of rehabilitation). Ord. § 5703.28(a). A third option allows adjustments for increased costs of debt service. Ord. § 5703.28(b). The fourth method, essentially a landlord hardship provision, requires the hearing officer to balance seven factors in determining the reasonableness of the proposed increase: (1) the landlord's financing costs; (2) the rental, (3) maintenance, and (4) service history on the premises; (5) other financial information provided by the landlord; (6) existing market value rents for comparable units; and (7) tenant hardship. Ord. § 5703.28(c). Only rent increases under the entirely optional fourth method are subject to consideration of the tenant hardship factor.

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[2] Fisher, 37 Cal.3d 644, 682 (1984). See so Cotati Alliance for Better Housing v. City Cotati, 148 Cal. App.3d 280, 289-91 (1983).

These adjustment mechanisms beyond the 8-percent minimum are extraordinarily generous.[3] Owners can obtain substantial rent increases to offset increases in debt service, with no requirement that such increased debt service be associated with property improvements.[4] San Jose's individual rent adjustment provisions also permit the consideration of comparable market value rents. Ord. § 5703.28(c)(6). Again, this is extraordinary because it runs directly contrary to the purpose of rent control. Finally, San Jose's ordinance offers yet another generous advantage to landlords in the form of vacancy decontrol. Landlords may raise rents to whatever level they please as long as the tenant has voluntarily vacated or been evicted for an enumerated cause. Ord. § 5703.3(b).[5]

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[3] It is not at all clear that individual adjustment mechanisms are constitutionally required. Certainly other price controls, such as regulations of taxi fares and milk prices, do not include such mechanisms, and they have not been ruled facially unconstitutional on that basis. "[I]t has never been thought that price fixing, otherwise valid, was improper because it was on a class rather than an individual basis." Bowles v. Willingham, 321 U.S. 503, 518 (1944).

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[4] Many other ordinances do not permit rent increases for increased debt service because, as noted by the California Supreme Court, such provisions award "windfall returns." Fisher, 37 Cal.3d 644, 691-92 (1984). As one commentator has aptly noted: "Formulas which include debt service as an expense in effect let sellers, purchasers, and lenders determine what rents shall be permitted. To this extent . . . [such] standards defeat the regulatory purposes of rent controls." Baar, Guidelines for Drafting Rent Control Laws: Lessons of a Decade, 35 RUTGERS L. REV. 723, 788 (1983).

Given these exceptionally liberal provisions, it is highly ironic that San Jose must here defend the constitutionality of its efforts to accommodate the economic interests of landlords. Fortunately, the ordinance fully satisfies existing constitutional requirements.

B. *San Jose's Law Provides a Fair Return in Every Case*.

Judicial review of price and rent control legislation has resulted in the development of the constitutional "fair return" doctrine. Although courts have also used language such as "avoiding confiscatory results" to describe the constitutional standard,[6] the fair return requirement apparently emanates from the due process clause rather than the takings doctrine.[7] The fair return concept has defied precise definition.[8] For courts, this involves a balancing of the interests of the consumer and general public with the interests of the landlord.[9] Moreover, fair return does not require any specific formula for its achievement.[10]

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[5] At least one commentator has stated that where vacancy decontrol is adopted, "it would not be improper to say that rent control no longer exists . . . ." Sheldon, *Rethinking Rent Control: An Analysis of Fair Return*, 12 RUTGERS L.J. 617, 637-38 n.156 (1981) (quoting *The ABC's of MBR: How to Spell Trouble in Landlord/Tenant Relations*, 10 COLUM. J.L. & SOC. PROBS. 113, 117 (1974)).

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[6] Fisher, 37 Cal.3d 644, 679, 693 P.2d 261 (1984), appeal of due process issues dismissed for want of a substantial federal question, 471 U.S. 1124 (1985) (complaint had alleged, inter alia, violations of due process, equal protection and takings clauses); Birkenfeld v. City of Berkeley, 17 Cal.3d 129, 165 (1976), and Helmsley v. Borough of Fort Lee, 78 N.J. 200, 394 A.2d 65 (1978).

[7] Analysis of this Court's takings cases is conspicuously absent from judicial discussions of the fair return doctrine. See, e.g., Bowles, 321 U.S. 503 (1944); Minden v. Cost of Living Council, 362 F. Supp. 298 (D. Neb. 1973); Zussman v. Rent Control Bd., 371 Mass. 632, 359 N.E.2d 29 (1976); Niles v. Boston Rent Control Adm'r, 6 Mass. App. Ct. 135, 374 N.E.2d 296 (1978); or Marshall House, Inc. v. Rent Control Bd., 358 Mass. 686, 266 N.E.2d 876 (1971); Birkenfeld, 17 Cal.3d 129 (1976); and Helmsley, 78 N.J. 200, 394 A.2d 65 (1978).

[8] One commentator has stated, "The exact point [of fair return] is a matter of moral and economic judgment; extortion should be prevented but new capital should not be discouraged."

Similar to judicial inquiry in the takings area, fair return analysis generally employs an ad hoc fact-bound inquiry which examines the result reached by the administrative agency, not the method used.[11] Because there are no facts available for analysis on this record, this Court is limited to an examination of whether the ordinance on

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Willis, "Fair Rents" Systems, 16 GEO. WASH. L. REV. 104, 118 (1947).

[9] Troy Hills Village v. Township Council of the Tp. of Parsippany-Troy Hills, 68 N.J. 604, 350 A.2d 34 (1975).

[10] Carson Mobilehome Park Owners Ass'n v. City of Carson, 35 Cal.3d 184, 672 P.2d 1297 (1983); Fisher, 37 Cal.3d 644, 693 P.2d 261 (1984).

[11] See Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944); Carson, 35 Cal.3d 184 (1983); Fisher, 37 Cal.3d 644 (1984).

its face could be administered without a confiscatory result.[12]

Appellants contend that the ordinance's inclusion of the tenant hardship factor facially operates to deny landlords a just and reasonable return. Appellants' Brief at 8-14.[13] Because this contention ignores the express language of the ordinance, as well as the inherently result-oriented nature of fair return case law, their facial challenge cannot stand. Nothing on the face of San Jose's ordinance precludes landlords from receiving a fair return. To the contrary, there is no question that its express language guarantees landlords a fair return.[14] Hearing officers must balance the factor of tenant hardship along with six other factors only if the landlord opts to seek a rent increase under the fourth method, a method which provides more than the constitutional fair return minimum. See Ord. § 5703.29. In any case, hearing officers must ensure that a proposed decision provides a fair and reasonable return to the landlord. Ord. § 5703.28. Courts must presume that the rent board will act consistently with the Constitution; if not, "the fault lies with the Board and not the statute."[15]

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[12] Permian Basin Area Rate Cases, 390 U.S. 747, 768-70 (1968), FPC v. Texaco, Inc., 417 U.S. 380, 392-93 (1974); FPC v. Natural Gas Pipeline Co. 315 U.S. 575, 585 (1942); Birkenfeld, 17 Cal.3d 129 (1976); Fisher, 37 Cal.3d 644 (1984); Hutton Park Gardens v. Town Council of West Orange, 68 N.J. 543, 350 A.2d 1, 15 (1975).

[13] Appellants have variously raised this contention in the context of substantive due process and asserting ripeness, without expressly making a fair return challenge as such. Because of the critical role of the fair return concept in this case, amicus addresses the fair return issue separately here.

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[14] See Ord. §§ 5701.2, 5703.28; San Jose City Council Resolution No. 59907 (June 16, 1987) (Appellees' Brief, App. B).

[15] Fisher, 37 Cal.3d 644, 684 (quoting Butterworth v. Boyd, 12 Cal.2d 140, 149, 82 P.2d 434 (1938)).

Here, the ordinance is not drawn so narrowly that a confiscatory result is inevitable, should the tenant hardship factor be applied to a specific factual situation, and therefore any facial fair return challenge necessarily must be rejected.[16] Appellants' apparent facial fair return challenge is neither ripe for review,[17] nor could it be sustained here here, given the express language of the ordinance at issue.

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[16] As the court below stated, the ordinance grants "all landlords the same constitutional fair return, and simply grants to those whose tenants can afford it an additional increase above that constitutionally required" under the fourth rent increase method." Pennell v. City of San Jose, 42 Cal.3d 365, 370 n.5 (1986). This interpretation has been affirmed by the San Jose City Council. See San Jose Resolution No. 59907 (June 16, 1987) (all landlords receive a minimum fair return on the value of property while some may obtain a greater return under certain circumstances).

[17] In its brief, amici National Association of Home Builders and the California Building Industry Association stated that "[b]y making clear that the tenant economic hardship provision

II. SAN JOSE'S TENANT HARDSHIP PROVISION DOES NOT WORK A FACIALLY UNCONSTITUTIONAL TAKING OF APPELLANTS' PROPERTY.

The takings clause of the Fifth Amendment, applicable to the states via the Fourteenth Amendment, does not cover legitimate regulatory action under the police power, notwithstanding an unequal distribution of benefits and burdens resulting from the regulation.[18] Rather, the takings jurisprudence developed by this Court reflects a deliberately limited scope, seeking to protect the interest of individual private parties in avoiding the assumption of public burdens

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may never override an owner's constitutional right to a reasonable return, the City of San Jose can cure its ordinance's violation of the guarantee proffered by the just compensation clause." Amici National Association of Home Builders and the California Building Industry Association Brief at 19 (emphasis in original). Since this has been done, no fair return controversy remains.

[18] Connolly v. Pension Benefit Guaranty Corp., 106 S.Ct. 1018, 1025 (1986).

which ought properly to be the responsibility of society at large.[19] This Court has found a constitutional violation only when an exercise of the police power has gone "too far,"[20] deprived an owner of "all economically viable use of the property,"[21] or appropriated a possessory interest.[22] No such taking could result from the San Jose rent control ordinance on its face.

Appellants' apparent claim is that

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[19] Armstrong v. United States, 364 U.S. 40, 49 (1960).

[20] Pennsylvania Coal Co. v. Mahon, 260 U.S. 393 (1922).

[21] Agins v. City of Tiburon, 447 U.S. 255 (1980).

[22] This Court's cases have involved appropriations directly from existing uses (Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419 (1982); Kaiser Aetna v. United States, 444 U.S. 164 (1979)) or indirectly, in exchange for the granting of some public privilege but without a sufficient relationship between the condition and the public purpose (Nollan v. California Coastal Comm'n, ___ U.S. ___, 55 U.S.L.W. 5145 (June 26, 1987)).

San Jose's tenant hardship provision facially operates to take their property because it is a disguised exercise of eminent domain without providing for just compensation.[23] Under the tenant hardship provision, so the argument goes, landlords are forced to "subsidize" tenants and this subsidy constitutes a public use of protected property interests, requiring just compensation under the Constitution.[24] Seeking to take advantage of the "possessory takings" theme most recently developed in Loretto, Kaiser Aetna, and Nollan, appellants further contend that the tenant hardship provision, when combined with the ordinance's retaliatory eviction protection, effects a taking by physical occupation, requiring just compensation without regard to the actual economic impact of the ordinance on the owner's property.[25]

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[23] Appellants' Brief at 23-26.

[24] Appellants' Brief at 26-28.

Appellants' facial takings claim cannot be sustained because nothing of constitutional significance has been or will, with certainty, be taken by the terms of the ordinance. Accordingly, at this point, the takings clause provides them no protection.

A. This Taking Claim Is Far From Ripe.

Despite the controversy that has surrounded the application of takings doctrine, at least one clear principle has emerged: the Court's analysis of takings claims is "essentially [an] *ad hoc*, factual inquiry." *Kaiser Aetna v. United States*, 444 U.S. 164 (1979); *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104 (1978). Critical to this inquiry are several factors, including the economic impact of the regulation, its interference with reasonable investment-backed expectations, and the character of the governmental action. Because of the fact-bound nature of the takings inquiry, appellants' claim is simply not ripe for this Court's analysis.

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[25] Appellants' Brief at 28-30.

The essential facts necessary for a takings analysis are totally absent from this record. This Court has _no_ information concerning appellants' financial situation with respect to particular properties to which the challenged provision might apply. Indeed, this Court has no indication that a tenant would contest a proposed increase under the fourth method or that San Jose would apply the challenged provision to appellants. No one knows whether the provision will be applied just to large rent increases or to all of them, or whether such increases will be delayed or totally denied. If it were applied, it is unknown what the actual economic impact would be.[26] There are no allegations concerning appellants' investment-backed expectations. In short, it is impossible to assess the character of San Jose's action because the provision has not been applied to appellants, nor to any particular landlord.[27] As this Court has often recognized,

> The constitutionality of statutes ought not to be decided except in an actual factual setting that makes such a decision necessary. . . . Adherence to this rule is particularly important in cases

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[26] It could be $10 a month in one unit of a 10-unit building, or it could be $50 a month in all of them. The rent could be $200 or it could be $800. Even under the fourth method with the tenant hardship factor, the landlord might receive a greater increase than under any other method.

[27] Since we must assume that the government will administer the ordinance constitutionally, any interference with property would be that naturally arising from a public program

> raising allegations of an unconstitutional taking of private property.

Hodel v. Virginia Surface Mining and Reclamation Association, Inc., 452 U.S. 264, 295-96 (1981).[27a] In such a case, as here, "the only issue properly before the . . . [Court], is whether the "mere enactment" of the . . . [Act] constitutes a taking." Hodel, 452 U.S. at 296-97.[28]

Under Hodel, the proper test to analyze a facial regulatory takings challenge is that propounded in Agins: "A statute regulating the uses that can be made of property effects a taking if

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"adjusting the benefits and burdens of economic life to promote the common good." See Penn Central, 438 U.S. 104, 125 (1978). See also Connolly., 106 S.Ct. 1018 (1986).

[27a] Applying these principles, the Ninth Circuit recently upheld a dismissal of a challenge as premature. Amberhill, 814 F.2d 1340 (9th Cir. 1987). This Court should do the same.

[28] See also Keystone Bituminous Coal Association v. DeBenedictis, 107 S.Ct. 1232, 1247 (1987).

it 'denies an owner economically viable use of his land. . . .'" 452 U.S. at 296-97, (quoting Agins v. City of Tiburon, 447 U.S. 255, 261 (1980)). Appellants bear a "heavy burden" of sustaining such a facial challenge. Keystone Bituminous Coal Association v. DeBenedictis, 107 S.Ct. 1232, 1250 (1987).

Under this test, San Jose's rent control ordinance easily holds its own. First and foremost, in all circumstances, it guarantees landlords a fair return.[29] In addition, it allows decontrol of rents upon vacancies;[30] allows evictions for any reason other than retaliation;[31] provides for generous automatic rent increases regardless of a tenant's financial situation;[32] and establishes other methods a landlord may elect to yield even higher rent increases, only one of which permits consideration of tenant hardship,[33] subject even then to the fair return guarantee. Since the ordinance is clearly not facially confiscatory under due process standards,[34] it obviously satisfies the far less exacting Agins "no economically viable use" takings standard.

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[29] Ord. §§ 5701.2, 5703.28.

[30] Ord. § 5703.3(b).

[31] Ord. § 5706.1.

Because nothing in the record indicates either an actual application of the challenged provision to appellants or any economic impact on them, much less one of constitutional dimension, "[t]he potential for . . . administrative solution confirms the conclusion that the taking issue . . . simply is not ripe for judicial resolution." Hodel, 452 U.S. at 298. For the same reason that courts are extremely reluctant to invalidate rent control ordinances as facially confiscatory on due process grounds,[35] any adjudication of the takings issue must await an "as applied" challenge.[36] Until San Jose's provision has been applied to a particular landlord in a specific factual situation, it is simply impossible to determine the existence of any unconstitutional loss or interference with property rights.[37]

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[32] Ord. § 5703.2.

[33] Ord. § 5703.28.

[34] Birkenfeld, 17 Cal.3d 129, 165 (1976); and Fisher, 37 Cal.3d 644, 679, 693 P.2d 261 (1984). See Section I, supra.

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[35] Fisher, 37 Cal.3d 644, 679, 693 P.2d 261 (1984); Carson, 35 Cal.3d 184, 192, 672 P.2d 1297 (1983); and Amberhill, 814 F.2d 1340 (9th Cir. 1987).

[36] Pennell, 42 Cal.3d 365, 375, 721 P.2d 1111 (1986).

[37] Nothing in this Court's recent decision in Nollan, ___ U.S. ___, 55 U.S.L.W. 5145 (June 26, 1987), commands a different result here. In Nollan, a possessory taking case, this

B. The Takings Clause Does Not Protect Appellants' Expectation Interests.

A second fundamental weakness of appellants' taking claim is that it seeks constitutional protection for mere expectation interests. Both this ordinance and the due process clause constitutionally guarantee a landlord that the operation of a rent control law will

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Court employed a second facet of the Agins decision to invalidate a permit condition requiring grant of a lateral access easement. Employing Agins' requirement that a land use regulation substantially advance a legitimate state interest, this Court established that judicial scrutiny demands a close connection between the means chosen and the ends sought to be achieved. Nollan provides no solace to appellants for two independent reasons.

First, for the same reason that Hodel required a factual record for evaluation of the "no economically viable use" issue, the means/ends nexus analysis of Nollan and Agins cannot be conducted on a barren factual record. At the very least, the record must disclose application of the challenged regulation to appellants and some inquiry into possible justifications for the means chosen. Second, and more importantly, as explained infra at 39, San Jose's ordinance directly satisfies any nexus inquiry.

provide a fair return.[38] There is no constitutional entitlement to more than a fair return. The "property" allegedly "taken" in this case is nothing more than the possible loss of some amount of future financial gain above the constitutional minimum fair return.[39]

The basic flaw in appellants' analysis is their implicit assumption that they have a constitutional entitlement to the specific monetary return provided by using only six factors of the optional fourth rent increase method -- a return that is reduced by consideration of the seventh factor, tenant hardship.[40] Not only is this assumption insupportable in light of the discretionary balancing inherent in the administration of that provision, but also it has no connection to the constitutional doctrine of fair return.[41] Finally, it reveals an extraordinarily presumptive substitution of appellants' will for the express intent of the legislature. In light of the large rent increases that would result, one simply cannot say that the San Jose City Council would have enacted the fourth rent increase method if it were not tempered by consideration of tenant hardship. To the contrary, given the central purpose of rent control -- to keep rents affordable wherever possible -- the hardship provision must be viewed as a key part of the fourth method. The whole package represented by

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[38] Ord. §§ 5701.2, 5703.28; San Jose City Council Resolution No. 59907 (June 16, 1987) (Appellees' Brief, App. B).

[39] Even the existence of such a loss is completely speculative in the absence of a specific factual record.

[40] Appellants' Complaint (¶ VI) only seeks to invalidate the tenant hardship factor, not the

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entire fourth rent increase method. See Joint Appendix at 5.

[41] See § I, supra.

all of the factors enumerated in that method comprises the legislative determination of reasonableness and therefore defines their entitlement.[42]

While the protection of expectation interests raises considerations of ripeness and justiciability absent a concrete dispute,[43] this Court has also established a substantive rule denying constitutional protection to such interests. "Mere unilateral expectation . . . is not a 'property interest' entitled to protection under the Fifth Amendment." Webb's Fabulous Pharmacies, Inc. v.

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[42] Since "property" is created by existing rules, Ruckelshaus v. Monsanto, 476 U.S. 986, 1001 (1984), appellants cannot delete a key term of the ordinance they challenge and claim that the remainder that is to their liking is their "property." See also Keystone, 107 S.Ct. 1232, 1248 (1987). Of course, the tenant hardship provision can never be applied to reduce a landlord's return below the constitutional fair return minimum.

[43] Williamson County Regional Planning Comm'n v. Hamilton Bank of Johnson City, 473 U.S. 172, 105 S.Ct. 3108, 3121 (1985).

Beckwith, 449 U.S. 155, 162 (1980). Again, in Andrus v. Allard, this Court noted that

> loss of future profits -- unaccompanied by any physical property restrictions -- provides a slender reed on which to rest a takings claim. Prediction of profitability is essentially a matter of reasoned speculation the courts are not especially competent to perform. Further, perhaps because of its very uncertainty, the interest in anticipated gains has traditionally viewed as less compelling than other property-related interests.

444 U.S. 51, 67 (1979).

Andrus upheld against a takings claim a statute regulating the sale of eagle feathers despite its drastic effect on the expectation interests of feather owners. Just as it was reasonable for Congress to conclude that financial gain would endanger the goal of eagle preservation by creating powerful incentives to evade statutory prohibitions against taking birds,[44] it was reasonable for San Jose to make a legislative judgment that rent increases under the fourth method, unchecked by a tenant hardship provision, present a threat to preserving economic diversity in the community. Absent the tenant hardship provision, this fourth method presents the obvious danger of totally nullifying the salutary effects of rent control altogether by permitting economic returns indistinguishable from those available in an unregulated market.[45] Certainly San Jose could reasonably include a tenant hardship factor in order to avoid a complete vitiation of its rent control program.

Adjusting landlords' rights for the

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[44] 444 U.S. at 59.

[45] In fact, the fourth rent increase method allows the consideration of market value rents for "comparable units," many of which have high rents resulting from vacancy decontrol. Ord. § 5703.3(b).

public good, though certainly curtailing some potential for economic exploitation of property, does not implicate the takings clause. Andrus, 444 U.S. at 66; Connolly, 106 S.Ct. 1018, 1026 (1986). Protection of appellants' expectation interests in this case would effectively prohibit reasonable economic regulation in pursuit of the public welfare under the police power and would render all price control laws constitutionally invalid.[46] This is not the proper case for the Court to take such an unprecedented step.

C. San Jose's Ordinance Does Not Work a Compensable Taking.

Even if appellants' claim were ripe and protectable, it has no support in takings doctrine. This Court has recognized only two types of compensable takings that can result from the exercise of police power: physical occupation[47] or temporary taking.[48] Because appellants have shown no deprivation of all use here, nor could they, the temporary taking category is wholly inapplicable to this case.

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[46] This is apparently the objective of numerous of the amici in support of appellants. See, e.g., Brief of Amicus Competitive Enterprise Institute at 5-12; Brief of Amicus National Association of Realtors at 6-11.

Appellants' reliance upon a theory of taking by physical occupation depends upon a highly imaginative use of this

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[47] *Loretto*, 458 U.S. 419 (1982) (ordinance requiring permanent occupation of owner's property by television cable constituted a taking); *Nollan*, ___ U.S. ___, 55 U.S.L.W. 5145 (June 26, 1987) (building permit conditioned on provision of lateral public access to beach in front of house constituted a taking because insufficient relationship to legitimate purpose); *United States v. Causby*, 328 U.S. 256 (1946) (frequent intrusion over land adjoining airport destroyed existing use as chicken farm); *Kaiser*, 444 U.S. 164 (1979) (requirement that owners of private lagoon allow public use constituted a taking).

[48] *First English Evangelical Lutheran Church of Glendale v. County of Los Angeles*, ___ U.S. ___, 55 U.S.L.W. 4781 (June 9, 1987) (regulation went "too far," depriving all use of property); *Pennsylvania Coal*, 260 U.S. 393, 415, (1922).

Court's "physical invasion" cases.[49] Essentially, appellants claim that the tenant hardship provision, when combined with the retaliatory eviction protections of the ordinance, effect a taking by physical occupation. Appellants' Brief at 29-30. Once a landlord has a hardship tenant, so the argument goes, the retaliatory eviction protections of the law require the landlord to continue renting to that tenant, absent a nonretaliatory reason to evict. Appellants primarily rely on Hall v. City of Santa Barbara, 797 F.2d 1493 (9th Cir. 1986), modified, 813 F.2d 198 (1987), where the court found that a local ordinance creating transferable possessory interests with economic value might constitute a taking.[50]

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[49] Just as with appellants' other taking theories, the addition of this facet to their takings claim fails to cure the fatal ripeness problem. Absent specific facts, appellants' "physical invasion" claim is reduced to an assertion that a legislative body's retaliatory eviction protections for tenants effect an unconstitutional physical invasion. As demonstrated infra, at 36-37, this contention is without any judicial support.

In contrast, San Jose's ordinance creates no marketable possessory interest with windfall economic value for tenants. If a tenant ever obtained administrative consideration of hardship status in the fourth rent increase process, that individual could not legally transfer a possessory interest in the unit to another tenant at the same "hardship" rent in exchange for an economic benefit. In fact, the vacancy decontrol provisions of the ordinance permit the owner to increase the rents to market levels upon most vacancies.[51]

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[50] Both the facts and the law at issue in Hall are easily distinguishable from this case. There, the ordinance required park owners to give mobile home tenants leases of unlimited duration at controlled rents. Since tenants owned their own trailers and could not be forced to move them when they personally desired to move out, in the court's view, the tenants were able to reap a windfall from the sale of their trailers to buyers eager to assume a rent-controlled tenancy. Thus, the court found that the ordinance created a marketable possessory interest in the owner's property, and it was this ability to capture some of the economic benefit resulting from rent control by the sale of the trailer at an uncontrolled price that the court found determinative of the takings question.

While the ordinance does impose legitimate restrictions upon an owner's ability to evict tenants for retaliatory reasons, appellants have not been denied their fundamental "right to exclude" by the ordinance in a constitutional sense.[52] Protected tenants entered into possession with the consent of the landlord and are protected only from arbitrary and capricious evictions by the retaliatory eviction provision. Under the San Jose law, an owner may still evict for any legitimate nonretaliatory reason. Retaliatory and (even more common and far reaching in the rent control area) good cause for eviction protections have been judicially recognized by this Court and many others as a necessary adjunct to effective rent control, particularly where the rent controls permit market rent increases for vacancies.[53] Without such protections, the purposes of San Jose's rent control program could be completely undermined by actual or threatened evictions.

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[51] Ord. § 5703.3(b).

[52] See Kaiser Aetna v. United States, 444 U.S. 164. 181 (1979); Pruneyard Shopping Center v. Robins, 447 U.S. 74, 84 (1980); Loretto, 458 U.S. at 434; Nollan, 55 U.S.L.W. at 5146.

The physical invasion doctrine has been employed by this Court only in situations where the government activity has destroyed a preexisting use (Causby), has directly appropriated a possessory interest in real property used as a person's home (Nollan), has permanently physically invaded commercial property by imposing a new possessory burden on a preexisting use (Loretto), or required public use of formerly private property (Kaiser Aetna). Loretto itself approved state and local governments' "broad power to regulate housing conditions in general and the landlord-tenant relationship in particular without paying compensation for all economic injuries that such regulation entails." 458 U.S. 419, 440.[54] Since it does not come within the ambit of this Court's "physical invasion" cases, San Jose's ordinance must fall within its broad regulatory power over housing conditions and the landlord-tenant relationship.

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[53] *Edgar A. Levy Leasing Co., Inc. v. Siegel*, 258 U.S. 242 (1921); *Taylor v. Brown*, 137 F.2d 654, 662 (U.S. Emergency Ct. App. 1943), *cert. denied*, 320 U.S. 787 (1943), cited with approval in *Parker v. Fleming*, 329 U.S. 531 (1947); *Block v. Hirsh*, 256 U.S. 135 (1921); *Troy, Ltd. v. Renna*, 727 F.2d 287 (3d Cir. 1984); *see also* Baar, 35 RUTGERS L. REV. 723, 833-35 (1983).

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[54] See also Troy, Ltd. v. Renna, 727 F.2d 287, 302 (3d Cir. 1984) (upholding New Jersey statute prohibiting eviction of certain tenants for 40 years after date of conversion of apartment to condominium).

Nothing in Nollan produces a different result because San Jose's ordinance fully satisfies that nexus requirement.[55] Considering tenant hardship as part of the optional fourth rent increase method also satisfies Nollan for another critical reason. Nollan established that government may adopt strict measures that advance legitimate objectives so long as the interference is not so drastic as to constitute a taking.[56] Lesser restrictions on property rights are constitutional so long as they serve the same legitimate purpose.[57]

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[55] Its stated purpose is "to permit landlords a fair and reasonable return on the value of their property while protecting tenants from arbitrary, capricious or unreasonable rent increases, and under certain circumstances, unjustified economic hardship. . . ." (Ord. § 5703.28.) The legitimacy of this stated purpose cannot be seriously disputed. As stated by this Court in Nollan, "[our cases] have made clear . . . that a broad range of governmental purposes and regulations satisfies these requirements." ___ U.S. at ___, 55 U.S.L.W. at 5147. In contrast to the absence of a reasonable connection between Nollan's lateral access condition and its purposes, the tenant hardship provision here exhibits a close and direct connection to the ordinance's stated purpose. The ordinance permits a hearing examiner, when a landlord elects to seek a rent increase under this method, to balance the factor of tenant hardship along with six other factors to determine a reasonable rent, always equal to or higher than the constitutionally required minimum. This process, in the City's judgment, will avoid placing undue hardship on any individual tenant challenging a proposed increase sought under this method. A closer fit for Nollan's "nexus" requirement, is difficult to imagine.

In Nollan, Justice Scalia pointed out that if the government could constitutionally deny the permit and ban reconstruction of the house in order to advance its legitimate objectives, the government could establish a lesser restriction in the form of a permit condition if that would serve the same purpose, despite the fact that the condition might require some concession of property rights (e.g., in Nollan, a condition that the owner grant a viewpoint easement if reconstruction would block public views). San Jose can certainly constitutionally establish a mechanism for providing rent increases beyond the fair return minimum that considers tenant hardship as one of seven relevant factors. This method accomplishes the stated purposes of the ordinance to provide fair returns to landlords while protecting tenants from unreasonable rent increases and hardship. Because it is not facially confiscatory under fair return analysis, use of the tenant hardship factor in the fourth rent increase method surely is not "so drastic" as to constitute a facial taking.

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[56] Nollan, ___ U.S. ___, 55 U.S.L.W. at 5147, citing Penn Central, 438 U.S. 104, 127 (1978).

[57] Id. at 5147.

III. THE SAN JOSE ORDINANCE'S USE OF A TENANT HARDSHIP FACTOR DOES NOT VIOLATE DUE PROCESS BECAUSE IT IS RATIONALLY RELATED TO LEGITIMATE GOVERNMENTAL PURPOSES.

Appellants' claim that the tenant hardship provision violates substantive due process because, while rationally related to the purpose of alleviating undue tenant hardship, that purpose is itself improper. Appellants' Brief at 13-14. Further, appellants claim that the hardship provision lacks a rational relationship to what is concededly a legitimate legislative purpose, the elimination of excessive rents. Appellants' Brief at 11-19.[58] Neither of these claims has merit.

A. Economic Regulation Need Only Bear a Rational Relationship to a Legitimate Legislative Purpose.

It is well accepted that substantive

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[58] Subsumed here is a contention that the hardship provision is unrelated to any identifi-

due process requires only that a regulation bear a reasonable relationship to a proper legislative purpose. Nebbia v. People of the State of New York, 291 U.S. 502, 516 (1934); Nollan, ___ U.S. ___, 55 U.S.L.W. 5145, 5147 n.3 and 5149 (Brennan, J., dissenting) (June 26, 1987). The Constitution does not require a regulation to be logically consistent with its aims in every respect. Williamson v. Lee Optical of Oklahoma, 348 U.S. 483, 487-88 (1955). The legislative approach need only be rational, not perfect. City of New Orleans v. Dukes, 427 U.S. 297, 303 (1976). Legislative decision-makers have constitutional authority to experiment with new techniques and may determine without judicial interference whether policies underlying

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able threat to the public health, safety and welfare and therefore constitutes an arbitrary interference with personal liberty. Appellants' Brief at 18.

legislation advance the public welfare. Day-Brite Lighting v. State of Missouri, 342 U.S. 421, 423 (1952). Under these standards, San Jose's ordinance facially satisfies due process.

B. All of the Stated Objectives of San Jose's Ordinance Are Legitimate Public Purposes.

For reasons central to the distribution of power in a constitutional democracy, the judiciary customarily defers to legislative determinations concerning legitimate legislative purposes:

> So far as the requirement of due process is concerned, and in the absence of other constitutional restriction, a state is free to adopt whatever economic policy may reasonably be deemed to promote public welfare, and to enforce that policy by legislation adapted to its purpose. The courts are without authority either to declare such policy, or when it is declared by the legislature, to override it.

Nebbia v. People of the State of New York, 291 U.S. 502, 537 (1934). This Court reaffirmed this now long-standing deferential attitude toward evaluating the legitimacy of legislative purposes in Nollan v. California Coastal Commission, ___ U.S. ___, 55 U.S.L.W. 5145 (June 26, 1987), recognizing that "a broad range of governmental purposes satisfies the requirement of a legitimate state interest." "The judiciary does not sit as a 'superlegislature' to weigh the wisdom of legislative policies." Day-Brite Lighting v. State of Missouri, 342 U.S. 421, 423 (1952).[59] San Jose is therefore free to assess the needs of its community, set its own legislative objectives and determine the means for accomplishing them with no more than minimal judicial scrutiny.

The stated purpose of San Jose's

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[59] This Court has also recently ratified the identical deferential approach with respect to the determination of what constitutes a proper "public use" under eminent domain. Hawaii Hous. Auth. v. Midkiff, 467 U.S. 229 (1984).

rent control program is to alleviate some of the "more immediate needs created by San Jose's housing situation" that reflects a "growing shortage of and increasing demand for housing." Ord. § 5701.2. These needs include "the prevention of excessive and unreasonable rent increases, the alleviation of undue hardship upon individual tenants, and the assurance to landlords of a fair and reasonable return on the value of their property." Ord. § 5701.2.

The judiciary has previously upheld as legitimate legislative rent control objectives both the prevention of excessive rents and the provision of a just and reasonable return to landlords.[60] Consequently, appellants correctly do not challenge the validity of these two objectives.

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[60] See Fisher, 37 Cal.3d 644, 652 (1984), aff'd on other grounds, 475 U.S. 260, (1986); Birkenfeld, 17 Cal.3d 129, 166 (1976).

The City's third stated objective is to alleviate undue tenant hardship. Ord. § 5701.2. Since that is the obvious purpose underlying all rent control, whether stated or not, it is difficult to believe that it could be invalidated under conventional deferential standards of judicial review. In fact, similar objectives have been judicially sustained.[61] In Troy, Ltd. v. Renna, 727 F.2d 287, 298 (3d Cir. 1984), the Third Circuit upheld a statute granting "protected tenancy status" to eligible senior citizens and disabled tenants depending on a personal income test. The court found the broad remedial purpose of protecting the mental and physical health of individuals, particularly those limited to fixed incomes who might suffer greatly by eviction, to be a legitimate and reasonable public purpose. Similarly the California Supreme Court has twice upheld rent control ordinances against due process attacks where the legislation was designed to "alleviate hardship caused by rising and exorbitant rents"[62] or to "advance the housing policies of the City with regard to low- and fixed-income persons, minorities, students, handicapped and the aged."[63] Any distinction between the language of these various stated purposes is hardly of constitutional significance since any conceivable legitimate purpose will suffice. Underlying San Jose's law are the legitimate purposes of preventing the hardship posed by displacement of the poor by excessive rent increases and of maintaining an economically integrated community.[64]

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[61] Appellants place heavy reliance on Property Owners Ass'n, Etc. v. Township of North Bergen, 74 N.J. 327, 378 A.2d 25 (1977), for the proposition that it is unconstitutional to compel landlords to "subsidize" needy senior citizens. Appellants' Brief at 14-15. North Bergen was a compelled subsidy case where a constitutional fair return might not be provided. Here, the rent increase method employing tenant hardship is optional with the landlord, and a fair return is always guaranteed. Moreover, the court found no fault with the classification created or the purpose itself.

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[62] Birkenfeld, 17 Cal.3d 129, 137 (1976).

[63] Fisher, 37 Cal.3d 644, 652, 693 P.2d 261 (1984), aff'd on other grounds, 475 U.S. 260 (1986).

In order to obtain more intense scrutiny of San Jose's ordinance, appellants have characterized the City's objective in a variety of ways: as "a one-on-one subsidization of tenants by landlords" (Appellants' Brief at 14); as an attempt at "equalization or redistribution of economic or social power which takes property from A to give to B" (Appellants' Brief at 27); as an attempt to compel landlords "to assume the public's welfare burden to provide for the needy" (Appellants' Brief at 16); and as an attempt "to reduce rents below a reasonable level to alleviate the economic and financial hardship of individual tenants" (Appellants' Brief at 21).[65]

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[64] Cf. Block v. Hirsh, 256 U.S. 135, 155 (1921) (the public interest may change over time).

San Jose's possible employment of the tenant hardship factor to determine reasonable rent levels under the fourth rent increase method constitutes no more of a "subsidy" than does any other price or rent control provision. Courts have correctly acknowledged that any price control, including rent control, distributes economic benefit to the extent of the difference between unregulated market rates and regulated rates, thereby constituting a form of "subsidization."[66] Appellants have acknowledged the legitimacy of this result as inherent in any price control scheme. Appellants' Brief at 14. San Jose's fourth rent increase method essentially provides a safety valve for landlords, allowing them to get higher rents if their tenants can afford to pay them. Since San Jose could constitutionally eliminate this method altogether, and since landlords will seek to use that method only when it provides a more generous increase than any other method -- always at least the constitutionally minimum fair return -- use of that method including the tenant hardship factor actually has the effect of *reducing* the subsidization effect characteristic of most rent controls.[67]

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[65] Appellants' highly speculative characterizations substitute a hypothetical projection of their worst fears for the express language of the law. This Court has never granted review on the basis of purely speculative prediction of possible injury. To challenge a law, appellants must demonstrate "a realistic danger of sustaining a direct injury" as a result of the provision's operation or enforcement. Babbitt v. United Farm Workers National Union, 442 U.S. 289, 299 (1979). This appellants cannot do.

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[66] Pennell, 42 Cal.3d 365, 373 (1986) ("subsidizing"); Birkenfeld, 17 Cal.3d 129, 158-60 (1976); Fisher, 37 Cal.3d 644, 686 (1984).

We again emphasize that use of the hardship factor in the fourth rent increase method will not reduce rents *below* a reasonable level. San Jose has determined that a hearing examiner must balance all of the seven enumerated factors, including tenant hardship, under the fourth rent increase method to yield a "reasonable" rent level. In no circumstance, regardless of tenant hardship, will the landlord be deprived of a constitutional fair return.

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[67] Furthermore, the supply of and demand for rental units is heavily regulated by local zoning ordinances, reducing the supply of housing far below "free market" levels. These barriers to market entry are constitutionally legitimate (*see, e.g., Village of Euclid v. Ambler Realty,* 272 U.S. 365 (1926)) and effectively curb much competition in the rental housing market. They confer a substantial public benefit in the form of an exclusive right to supply rental housing on existing landowners. Such a benefit could as easily be termed a "subsidy" as that which may accrue to individual tenants under the possible use of the tenant hardship factor in the fourth rent increase method. Government is certainly free to impose restrictions reducing benefits resulting from other governmental activity without running afoul of the Constitution. *Nollan,* ___ U.S. ___, 55 U.S.L.W. 5145, 5147 (June 26, 1987).

Furthermore, the purpose of alleviating undue tenant hardship does not compel landlords to assume any burden whatsoever. The fourth method of calculating rent increases is triggered only upon an election by the landlord, at his or her option, when seeking a more generous increase than provided under any other method (always at least a fair return).

Finally, appellants' characterization of the objective as somehow attempting to redistribute the wealth is nothing more than a challenge to the wisdom of any legislation that has the effect of adjusting the benefits and burdens of economic life. This raises no constitutional difficulty.[68]

C. The Tenant Hardship Provision Is Rationally Related to All of the Stated Objectives of the Ordinance.

Due process requires only a conceivable rational relationship between a challenged provision and a legitimate governmental purpose. New Motor Vehicle Board of California v. Orrin W. Fox Co., 439 U.S. 96 (1978). The tenant hardship provision is therefore a legitimate exercise of police power if it is conceivably related to the elimination of excessive rents, the alleviation of undue tenant hardship, or the provision to landlords of a just and reasonable return. See Birkenfeld, 17 Cal.3d 129, 166 (1976).

Logically, any legislative provision need only relate to any one of the enumerated or conceivable legislative objectives. Any other conclusion would produce problems of enormous dimension for lawmakers, inevitably resulting in a multiplicity of single-sentence laws.

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[68] See Penn Central, 438 U.S. 104, 125 (1978).

Appellants acknowledge that the tenant hardship provision is rationally related to the alleviation of undue tenant hardship. Appellants' Brief at 13. If that is a legitimate legislative purpose, then this Court's constitutional inquiry is at an end. In addition to disputing the legitimacy of this purpose, appellants contend that the tenant hardship factor bears no relationship to the prevention of excessive rents or the provision of a just and reasonable return to landlords, because using the factor would reduce the rent below a "reasonable" level. Id. This assertion is also untenable.

Even if the alleviation of undue

tenant hardship is found to be an improper legislative purpose, the ordinance satisfies due process because the tenant hardship provision bears sufficient relationship to both of the ordinance's other stated purposes.[69] The City's decision-makers easily and reasonably could have concluded that the inclusion of the hardship factor would advance the objective of preventing excessive rents. After all, it obviously operates to keep rents down. Moreover, the City Council reasonably concluded that the hardship factor is relevant for determining what is a "just and reasonable" return for landlords. The Constitution requires no specific formula for yielding this return,[70] and a legislature exercising the police power certainly can factor individual hardship into its calculation of "reasonableness," so long as a constitutionally minimum "fair return" is provided. Allowing landlords to seek rent increases under the fourth method but conditioning those increases upon an examination of tenant hardship does not violate substantive due process.

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[69] The court below found the provision legitimately addressing the broader purposes of the ordinance in a "more precise fashion by differentiating between hardship and non-hardship tenants through the rational means of distinguishing between their respective landlords." Pennell, 42 Cal.3d 365, 375 (1986).

IV. SAN JOSE'S USE OF THE TENANT HARDSHIP PROVISION DOES NOT VIOLATE THE EQUAL PROTECTION RIGHTS OF APPELLANTS OR ANY LANDLORDS SUBJECT TO ITS APPLICATION.

Appellants contend that the challenged provision violates equal protection because it arbitrarily selects individual landlords to bear the burden of "subsidizing" poor tenants through a "species of taxation." Appellants'

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[70] *Carson*, 35 Cal.3d 184, 192, 672 P.2d 1297 (1983); *Fisher*, 37 Cal.3d 644, 680, 693 P.2d 261 (1984), *aff'd on other grounds*, 475 U.S. 260 (1986).

Brief at 19. As in appellants' substantive due process claim, their characterization of the legislative classification really amounts to little more than an attack upon the wisdom of any rent control program. As this Court has repeatedly recognized, this is not the proper forum for that challenge. Day-Brite Lighting, 342 U.S. 421, 423 (1952).

A. Use of the Tenant Hardship Provision to Treat Landlords Differently Bears the Requisite Rational Relationship to the Legitimate Purposes of Preventing Excessive Rent Increases and Undue Tenant Hardships.

It is well settled that "equal protection is not denied simply because an ordinance treats one class of persons differently from another."[71] Where there is no suspect classification or fundamental right involved,[72] a regulation satisfies equal protection if its classification is rationally related to a legitimate state interest. Massachusetts Board of Retirement v. Murgia, 427 U.S. 307 (1976). A challenged classification need only bear a "debatable" rational relationship to the legislative purpose in order to satisfy equal protection. Minnesota v. Clover Leaf Creamery Co.,

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[71] Walters v. City of St. Louis, 347 U.S. 231, 237 (1954); Cotati, 148 Cal. App.3d 280, 292 (1983).

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[72] Appellants and their amici have proposed some novel theories to encourage this Court to apply stricter scrutiny to the challenged provision. Appellants' Brief at 20-22. Amici National Apartment Association and California Apartment Association even have suggested that landlords be given status as a "suspect class" (even though that is not the classification at issue here) to invoke "intermediate review" of the provision. Amicus Brief of National Apartment Association and California Apartment Association at 11-13. Not surprisingly, this contention finds no support in the law. Just as tenants are not a suspect class, Lindsey v. Normet, 405 U.S. 56 (1972), landlords as a class exhibit none of the indicia used by this Court to elevate classes to a "suspect" status. See Frontiero v. Richardson, 411 U.S. 677, 685-88 (1973).

449 U.S. 456, 465 (1981).[73] In Nollan, this Court recently reaffirmed this fundamental and long-standing principle of deference to legislative choice in equal protection and due process cases, while applying a somewhat more exacting standard to taking claims. 55 U.S.L.W. 5145, 5147 n.3. Despite the disagreement concerning the applicability of this deferential due process/equal protection standard to takings claims, it is clear that there is no disagreement on this Court concerning traditional substantive due process and equal protection analysis.[74]

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[73] Judicial review for ordinary equal protection analysis is identical to that required for substantive due process. See Nollan, ___ U.S. ___, 55 U.S.L.W. at 5147 n.3 (June 26, 1987) (majority opinion) and at 5149 (Brennan, J., dissenting).

[74] Id. and 55 U.S.L.W. at 5149 (Brennan, J., dissenting). In fact, because San Jose's ordinance easily satisfies the more strict nexus inquiry of Nollan (see text, supra, at 39) by virtue of the perfect fit between the classi-

The "classification" really at issue in this case is that between landlords with and landlords without hardship tenants. Despite appellants' protests to the contrary, this challenged classification involves no fundamental rights or suspect class and therefore must be reviewed with minimal scrutiny. Appellants must therefore convince this Court that this classification has no rational basis. Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456, 464 (1981). This they cannot do.

Any classification resulting from use of the tenant hardship provision bears the requisite debatable relationship to a legitimate legislative purpose.[75] The stated purposes of the

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fication resulting from the hardship provision and the stated purpose of the ordinance, a fortiori, it easily survives traditional equal protection scrutiny.

[75] Appellants' equal protection claim is

ordinance are to prevent excessive and unreasonable rent increases, to ensure landlords a fair return on their property, and to alleviate undue hardship on individual tenants (Ord. § 5701.2). As demonstrated _supra_ with respect to appellants' due process claim, the classification resulting from use of the tenant hardship provision is closely related to all three of the City's stated purposes.[76] It is an integral part of an elective rent increase mechanism that is finely honed to prevent excessive rents and alleviate undue tenant hardship, while simultaneously providing all land- all landlords with _at least_ a fair return. Appellants' only remaining

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no more ripe than their taking and due process claims and is not justiciable for this reason alone. _See_ pp. Section IIA, _supra_.

[76] 76. _Cf. Troy, Ltd. v. Renna_, 727 F.2d 287 (3d Cir. 1984) (upholding anti-eviction statute protecting elderly and disabled tenants against impairment of contract and takings claims).

dispute is with the propriety of alleviating hardship as a legitimate public purpose, and, as demonstrated in Section IIIB, this contention must certainly be rejected. The judiciary does not "sit as a superlegislature to weigh the wisdom of legislation, nor to decide whether the policy it expresses offends the public welfare." Day-Brite Lighting v. State of Missouri, 342 U.S. 421, 423 (1952).

B. Kirchner and Its Progeny Are Inapposite to This Case.

Appellants primarily rely on a California case and its progeny for their equal protection argument. In Department of Mental Hygiene v. Kirchner, 60 Cal.2d 716, 388 P.2d 720 (1964), the California Supreme Court held that forcing parents of involuntarily confined state hospital inmates to bear the expense of commitment violated equal protection. Not only is this case irrelevant to a challenge based on the federal Constitution,[77] but California courts have construed narrowly the Kirchner holding to apply only to "responsible relative" reimbursement cases. Just as the court below declined appellants' invitation to extend Kirchner to this case,[78] this Court should decline the invitation as well.[79]

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[77] This Court vacated the appeal in Kirchner because it was uncertain whether the California court grounded its decision on the state or federal constitutions. 380 U.S. 194 (1965). The California court subsequently clarified that the decision was based upon the California Constitution. 62 Cal.2d 586 (1965).

[78] Pennell, 42 Cal.3d 365, 373 (1986).

[79] Even if this Court were to adopt the reasoning of Kirchner, the challenged ordinance would not violate equal protection under that theory because a landlord can elect whether to subject himself to the burdens imposed by the challenged classification. See, e.g., Terminal Plaza v. City and County of San Francisco, 177 Cal. App.3d 892, 911-12 (1986) (rejecting a Kirchner equal protection challenge to a requirement that owners converting residential hotel units pay replacement fees and relocation assistance because the burden could be avoided by an owner's election to refrain from conversion). Here, landlords will never face the tenant hardship provision and its resulting "classification" unless they elect to use the more generous fourth

CONCLUSION

Appellants in this case press an abstract and speculative challenge to San Jose's efforts to condition optional and extraordinary rent increases upon some consideration of tenant hardship so that the economic and human diversity of its community can be maintained. San Jose's attempt to strike a balance between protecting tenants and providing landlords with market returns does not raise a serious facial constitutional issue, and therefore the judgment of the California Supreme Court should be affirmed.

Respectfully submitted,

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rent increase method and the proposed increase is challenged by the tenant.

IN THE SUPREME COURT
OF THE UNITED STATES
October Term, 1987

No. 86-753

RICHARD PENNELL and TRI-COUNTY APARTMENT HOUSE OWNERS ASSOCIATION, Appellants,
v.
CITY OF SAN JOSE and CITY COUNCIL OF SAN JOSE, Appellees.

CERTIFICATE OF SERVICE

I hereby certify that on this 31st day of July, 1987, packages of three copies each of the foregoing Brief for Amicus Curiae National Housing Law Project were deposited in the Post Office at Berkeley, California, with first class postage, prepaid, addressed to:

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BRIEF

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On Appeal from the
Supreme Court of California

BRIEF OF ASIAN LAW ALLIANCE, LEGAL AID SOCIETY OF SANTA CLARA COUNTY, AND SENIOR ADULTS LEGAL ASSISTANCE AS *AMICI CURIAE* IN SUPPORT OF APPELLEES

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BRIEF OF ASIAN LAW ALLIANCE, LEGAL AID SOCIETY OF SANTA CLARA COUNTY, AND SENIOR ADULTS LEGAL ASSISTANCE AS AMICI CURIAE IN SUPPORT OF APPELLEES

INTEREST OF *AMICI CURIAE*

Pursuant to Supreme Court Rule 36, the Asian Law Alliance, the Legal Aid Society of Santa Clara County, and Senior Adults Legal Assistance submit this brief as *amici curiae* in support of appellees, the City of San Jose and the City Council of the City of San Jose.

Counsel for all parties have consented to the submission of this brief; letters of consent have been filed with the Clerk of the Court.

The three *amici curiae* are legal services organizations that represent indigent and low-income enants in the City of San Jose. The Asian Law Alliance is a nonprofit community law center that erves Asian/Pacific Islander refugees and immigrants n the San Jose area by providing legal representation nd multilingual counseling and community education. The Legal Aid Society of Santa Clara County is a non- rofit legal services agency that offers free civil egal assistance to indigent persons in the greater an Jose area. Senior Adults Legal Assistance is a onprofit corporation and law office that provides ree civil legal services to the elder residents of anta Clara County consistent with the mandate of the ederal Older Americans Act.

All three organizations have extensive experience n representing indigent and low-income tenants in arious landlord-tenant disputes, including unlawful

detainer actions, habitability actions, and rent control mediation and arbitration. Since the San Jose rent control ordinance was enacted in 1979, attorneys from our organizations have represented tenants in all stages of the rental mediation process.

Because the outcome of this case will affect tenants who require the protection of the San Jose rent control ordinance from excessive rent increases, our organizations have a strong interest in seeing the Court determine the ordinance's legality. Clients represented by our organizations have faced high rent increases, without the benefit of the tenant hardship provisions of the ordinance. The constitutionality of the San Jose rent control ordinance is, therefore, an issue in which the Asian Law Alliance, the Legal Aid Society of Santa Clara County, and Senior Adults Legal Assistance have a direct stake.

SUMMARY OF ARGUMENT

Contemporary urban housing markets provide little security for low-income tenants: housing is scarce, rents are high, alternatives are almost nonexistent. The City of San Jose, responding to its local housing market, has employed rent control to safeguard tenants from the difficulty and hardship that result from housing shortages and high rents. The tenant hardship provisions challenged in this case represent a unique method by which the City attempts to protect tenants from excessive rent increases while ensuring that landlords receive fair and reasonable returns.

From a landlord's perspective, the San Jose rent control ordinance is a highly permissive statute. The ordinance offers landlords an uncontestable annual rent increase of up to eight percent. Moreover, the ordinance permits increases above eight percent in three ways: (1) a five percent increase plus pass-through costs, (2) a fixed percentage of landlord debt service, and (3) an even higher increase set by weighing several factors, including landlord hardship and tenant hardship. Under the ordinance's balancing scheme, tenant hardship is used to limit a proposed rent increase. However, hardship never is used to compromise a landlord's reasonable return. On its face, the San Jose ordinance guarantees a fair and reasonable return in all cases.

Rent control ordinances exist in order to alleviate the undue hardship upon tenants that results from excessively high rents. Housing markets that offer neither stable supplies nor affordable prices require adjustments that protect tenants from exploitation. Thus, considering tenant hardship to limit a rent increase greatly in excess of a guaranteed minimum is hardly arbitrary or irrational. Particularly in the context of the San Jose ordinance, tenant hardship is an essential factor in a price-setting scheme under which landlords receive most of the benefits.

No taking of property occurs through the consideration of tenant hardship. Like other forms of economic regulation, rent control weighs consumer and investor interests to limit prices. Under the ordinance's balancing scheme, hearing officers adjust prices by using tenant hardship as a mitigating factor against several factors favoring landlords. Because the ordinance requires hearing officers to offer landlords a rental price that secures, at minimum, a fair and reasonable return, the ordinance does not confiscate private property for public use.

The San Jose ordinance does not require landlords to "subsidize" low-income tenants by any meaningful definition of the word, unless every limitation on price increases is a form of "subsidy." All price regulations, in some way, restrict sellers from charging the highest price obtainable on the market. But such restriction on a seller's expectations does not transfer any already realized interest unless it denies a fair return on investment.

The ordinance does not require landlords to finance low-income tenants by sacrificing a fair return. A landlord whose rent increase is lowered by tenant hardship may receive less profit than a similarly situated landlord, but no equal protection violation occurs. As long as all landlords receive at least the minimal fair return, any further differentiation is not onerous.

ARGUMENT

I

THE SAN JOSE RENT CONTROL ORDINANCE LIMITS RENT INCREASES WHILE ENSURING A FAIR RETURN

A. The Tenant Hardship Provisions are Designed to Offset Factors that Strongly Favor Landlords

Housing shortages pose a severe problem for residents of our nation's cities. Limited housing supplies and economic inflation have engendered markets that offer neither stability nor affordability. Low-income tenants, lacking both financial resources and political power, have been forced to endure acute hardship generated by excessive rents and scarce housing.

The City of San Jose, like many cities throughout the United States, has chosen rent control as a solution to the problem of providing affordable housing.[1]

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[1] Various amici curiae in support of appellants have cited studies condemning rent control as a means of providing affordable housing. Although these studies may

The San Jose Rental Dispute Mediation and Arbitration Ordinance, in its policy and purposes declaration, states:

> In order to protect the health, safety and welfare of the citizens of San Jose, this ordinance is a necessary measure designed to alleviate some of the more immediate needs created by San Jose's housing situation. These needs include but are not limited to the prevention of excessive and unreasonable rent increases, the alleviation of undue hardship upon individual tenants, and the assurance to landlords of a fair and reasonable return on the value of their property.

Section 5701.2, San Jose, Cal., Municipal Code § 17.23.020 (1986), *reprinted in* Jurisdictional Statement for Appellants at A-34.

Like other rent control laws, San Jose's ordi-

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provide some insight into the prudence of rent control as a public policy, they represent only one side of an ongoing debate and they are far from conclusive. See Weitzman, Economics and Rent Regulation: A Call for a New Perspective, 13 N.Y.U. Rev. L. & Soc. Change 975 (1985). In any case, the literature should not sidetrack the Court's inquiry into the constitutionality of the San Jose rent control ordinance. The issue in this case is not the wisdom of rent control as an urban economic policy. The question is much narrower: the Court must decide whether the consideration of tenant hardship in the setting of rent increases complies with the fifth and fourteenth amendments.

nance sets limits on annual rent increases.[2] The ordinance is unique, however, in that it explicitly weighs both landlord hardship and tenant hardship when determining rent increases greatly in excess of a guaranteed minimum. Landlords who request an annual rent increase above eight percent, or above levels justified by expenses and by debts passed through to the tenant, must comply with a test that examines, among other things, a tenant's financial hardship.

The ordinance offers an automatic annual rent increase of eight percent to all landlords within the scope of its coverage.[3] Section 5703.2, San Jose,

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[2] Compared to many rent control laws in California and in other states, though, the San Jose ordinance is relatively weak. See generally Baar, Guidelines for Drafting Rent Control Laws: Lessons of a Decade, 35 Rutgers L. Rev. 723 (1983). The ordinance sets a high automatic annual rent increase (eight percent), permits vacancy decontrol of a unit, allows the pass through of a high proportion of debt service, and makes automatic any increase over eight percent that is unchallenged by the tenant.

[3] The ordinance also allows a 21% automatic rent increase if the last increase occurred over two years earlier. Section 5703.5, San Jose, Cal., Municipal Code § 17.23.210 (1986) (as amended).

Cal., Municipal Code § 17.23.180 (1986). Alternatively, the ordinance establishes three methods to calculate rent increases above eight percent.[4] First, the ordinance allows a five percent increase plus pass-through costs, including costs of capital improvements, increased costs of maintenance and operation, and costs of rehabilitation. Section 5703.28(a), *id.* Second, the ordinance allows increased costs of debt service to be passed through to the tenant. Section 5703.28(b), *id.* Third, if a landlord desires an increase above amounts offered under the other two sections, the ordinance allows the landlord to invoke the cost-hardship balancing test. Section 5703.28(c), *id.*

Under the cost hardship test, tenant hardship is one of several variables included in a formula that

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[4] It is important to note that the San Jose rent control ordinance places on tenants the burden of challenging a rent increase above eight percent. Section 5703.6, San Jose, Cal., Municipal Code § 17.23.220 (1986). A landlord may voluntarily request a mediation hearing under the ordinance. Section 5703.7, id. § 17.23.230. However, unless the tenant files a petition before the effective date of the increase, the rent increase becomes automatic, regardless of the amount.

the San Jose ordinance employs to establish a proposed increase. In addition to tenant hardship, the relevant section of the ordinance lists six other factors: (1) debt service due to sale or refinancing, (2) rental history, (3) physical condition of the rental unit, (4) changes in housing services, (5) any other financial information provided by the landlord, and (6) market value for similar units.[5] Section 5703.28(c), San Jose, Cal., Municipal Code § 17.23.440 (1986).

Thus the ordinance allows high rent increases in three different ways before the cost-hardship balancing test is ever applied. Tenant hardship is never considered in automatic increases or in increases based on costs or debt service. Once the landlord invokes the balancing test, hardship is the only variable in which the tenants' condition is examined and this consideration is weighed against a variety of factors reflecting on the landlord's interests. Therefore, viewed in context of the whole ordinance and relative to the opportunities presented to the landlord, the tenant hardship provision is only a limited factor in the consideration of proposed rent increases.

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[5] The market value for similarly situated rental units, though an ostensibly neutral factor, can only skew the rent increase in favor of the landlord. Examining market value contradicts a basic presupposition of rent control: keeping rents at affordable levels below the market rate.

B. Appellants Misconstrue the Tenant Hardship Provisions

Appellants' primary challenge to the San Jose rent control ordinance rests upon their peculiar interpretation of the tenant hardship provisions. Under section 5703.29 of the ordinance, hearing officers "shall consider the economic and financial hardship imposed on the present tenant or tenants of the unit or units to which [the proposed] increases apply." San Jose, Cal., Municipal Code § 17.23.450 (1986). The section further directs an officer to "order that the excess of the increase . . . be disallowed," if, "on balance, the Hearing Officer determines that the

proposed increase constitutes an unreasonably severe financial or economic hardship . . . ." *Id.*

Appellants' interpretation of the ordinance assumes that hearing officers would reduce a minimally reasonable rent increase[6] to an unreasonable level. A proper reading of the ordinance indicates, however, that a landlord's reasonable return cannot be abridged by tenant hardship. The section establishing standards of reasonableness for rent increases states: "Hearing Officers shall determine whether rent increases are reasonable under the circumstances taking into consideration that the purpose of this Ordinance is to permit landlords a fair and reasonable return on the value of their property . . . ." Section 5703.28, San Jose, Cal., Municipal Code § 17.23.440 (1986). Moreover, the introductory portion of the ordinance's cost-hardship section states explicitly that "[i]n order to assure to landlords a fair and reasonable return on the value of their property, the Hearing Officer shall . . . determine what is reasonable under the circumstances . . . ." *Id.* Therefore, the tenant hardship provisions should not be interpreted as reducing a rent increase to an unreasonable level. Instead, the provisions can and should be interpreted as sustaining a reasonable rent increase after considering both landlord costs and tenant hardship.[7]

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[6] This Court has never established a constitutional minimum for a landlord's reasonable return, and it is not asked to do so in this case. The Court need not articulate a minimum to uphold the challenged provisions. As long as an increase provides a reasonable return, it should fall above any demarcation point that the Court may set in the future. Moreover, the Court need not decide on a particular standard to establish a reasonable rent increase. See Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 602 (1944) ("[I]t is the result reached not the method employed which is controlling . . . ."); Fisher v. City of Berkeley, 37 Cal. 3d 644, 680, 693 P.2d 261, 290, 209 Cal. Rptr. 682, 711 (1984) (cities not required "to fix rents by application of any particular method or formula"), aff'd on other grounds, 106 S. Ct. 1045 (1986).

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[7] Counsel for the City of San Jose suggest that subsection (c) should be interpreted in the following way: A hearing officer must start with an increase that is at minimum a fair return on the value of the landlord's property; then, the hearing officer balances the seven factors to set an increase that fits the particular circumstances. Appellees' Motion to Dismiss or Affirm at 5, 11. Another interpretation is the following: In a single step, a hearing officer balances all seven factors, including tenant hardship, to set a fair and reasonable rent increase. Because the tenant hardship provisions have yet to be applied, either interpretation is plausible. In

As the California Supreme Court properly stated: "[T]he ordinance provides that in *all* cases hearing officers must allow landlords a rent increase that yields a fair and reasonable return." *Pennell v. City of San Jose,* 42 Cal. 3d 365, 369, 721 P.2d 1111, 1114, 228 Cal. Rptr. 726, 729 (1986) (emphasis added).

Whether it is *possible* to adopt the appellant's interpretation is, in any case, not the issue. A statute is to be construed to avoid raising doubts of its constitutionality if such a construction is fair and reasonable. *See, e.g., St. Martin Evangelical Lutheran Church v. South Dakota,* 451 U.S. 772, 780 (1981); *Califano v. Yamasaki,* 442 U.S. 682, 693 (1979); *Crowell v. Benson,* 285 U.S. 22, 62 (1932). Because the City's interpretation of its own ordinance is clearly plausible, appellants' extreme reading should not be accepted by this Court.

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any case, appellants' interpretation of the section--that a hearing officer starts with a reasonable return and then uses tenant hardship to lower the return--is clearly wrong.

II

ALLEVIATING TENANT HARDSHIP IS A LEGITIMATE LEGISLATIVE PURPOSE

A. Preventing Tenant Hardship is the Justification for Any Rent Control Ordinance.

Legislative acts adjusting the burdens and benefits of economic life come to the court with a presumption of constitutionality; the burden is on the party complaining of the constitutional violation to establish that the legislation is not arbitrary and irrational. *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 15 (1976).

The San Jose rent control ordinance enumerates three concrete goals, each on its face reasonable and consistent with the City's legislative powers: (1) the prevention of excessive and unreasonable rent increases, (2) the alleviation of undue hardship upon individual tenants, and (3) the assurance to landlords of a fair and reasonable return on the value of their property. Section 5701.2, San Jose, Cal., Municipal Code § 17.23.020 (1986).

Appellants concede that preventing excessive rent increases and guaranteeing a landlord's reasonable return are valid goals of rent control. Appellants contend, however, that alleviating tenant hardship is not a valid goal of rent control because, under the San Jose ordinance, tenant hardship forces landlords to sacrifice a fair return in order to subsidize low-income tenants.

Again, appellants rely on the false assumption that the tenant hardship provisions reduce a rent increase below a reasonable level. As noted above, *see supra* Part I.B., the San Jose rent control ordinance guarantees a constitutionally fair return in all cases; even when tenant hardship weighs heavily in limiting a proposed rent increase, the landlord still receives a reasonable return.

Contrary to appellants' suggestion, there cannot be a dichotomy between the prevention of excessive and unreasonable rent increases and the alleviation of tenant hardship. Although the ordinance lists each goal separately, the two goals are complementary and cannot be segregated. Preventing excessively high rents and alleviating tenant hardship are two sides of the same coin. Both goals ensure that tenants can live in affordable housing; both goals protect tenants from a landlord's exploitation of a scarce housing supply. While recognizing the landlord's right to a fair return, cities regulate rents in order to protect tenants--especially the least powerful tenants--from undue hardship. *See, e.g., Birkenfeld v. City of Berkeley,* 17 Cal. 3d 129, 137, 550 P.2d 1001, 1008, 130 Cal. Rptr 465, 472 (1976) (purpose of rent control ordinance is to alleviate hardships endangering the public health and welfare, especially that of "the poor, minorities, students, and the aged"). An ordinance obviates tenant hardship by restricting excessive rent increases; an excessive rent increase is defined by its ability to cause economic hardship. Thus, any distinction between the two goals is artificial.

Alleviating the hardship imposed on tenants by inordinately high rents is the primary justification

for all rent control ordinances. An ordinance may list specific goals such as lowering rents, limiting inflation, maintaining an adequate housing supply, and assuring a fair return, but the basis for the ordinance's existence will always be the prevention of undue hardship upon tenants. *See Parrino v. Lindsay,* 29 N.Y.2d 30, 272 N.E.2d 67, 323 N.Y.S.2d 689 (1971); *Gillead v. Fordham Hill Owners' Corp.* 601 F. Supp. 530 (S.D.N.Y. 1985); *cf. Federal Power Comm'n v. Hope Natural Gas Co.,* 320 U.S. 591, 610-12 (1944) (utility rate setting designed to protect consumers from high prices and exploitation by natural gas companies); *Troy Ltd. v. Renna,* 727 F.2d 287, 298 (3d Cir. 1984) (eviction controls necessary to protect mental and physical health of citizens who could suffer greatly by evictions).

B. Specific Consideration of Tenant Hardship is Necessary to Protect Tenants in the San Jose Housing Market

The City of San Jose's decision to provide additional protection in its rent ordinance to residents suffering special economic hardship is a logical result of its effort to limit excessive and unreasonable rent increases. As discussed above, concern for mitigating hardship to consumers lies at the heart of any price control program, and the San Jose ordinance clearly and directly addresses that concern.

Ameliorating hardship to the individual consumer in the abstract is not the only rationale for the San Jose ordinance's hardship provision. The consideration of economic hardship, especially to low-income tenants, is rationally and empirically related to the nature of today's housing market.

In 1979, the year the San Jose ordinance was adopted, the U.S. Comptroller General reported that there existed a national rental housing market "crisis" with "particularly bleak prospects for lower income renters." U.S. Comptroller General, General Accounting Office, *Rental Housing, A National Problem That Needs Immediate Attention* 29 (1979). The Comptroller General found that there existed a severe shortage of rental units available to low-income per-

sons, that rent increases were exceeding increases in income, and that government subsidy programs were unable to meet outstanding need.[8] This shortage of low-income housing continues unabated, with the growing number of homeless as the most tragic evidence of the seriousness of the crisis. *See, e.g.*, M. Cuomo, *"Never Again:" Report to the National Governors Association, Task Force on the Homeless, reprinted in Homelessness in America, II: Hearings Before the Subcomm. on Housing and Community Development of the House Comm. on Banking, Finance, and Urban Affairs*, 97th Cong., 2d Sess. (1982).[9]

The special and particular nature of the low-

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[8] See, e.g., Special Committee on Aging, U.S. Senate, Developments in Aging: 1985 Volume I, Report 242, 99th Cong., 2d Sess., 259 (1986).

[9] The impact of the housing shortage is clearly felt most by the low income and of the market. For example, in the Western Region of the U.S., over half of all rental households earning less than $7000 a year spend over 60% of their incomes on rent. In comparison, less than one tenth of all rental households earning between $7000 and $20,000 spend a similar percentage of income on rent. U.S. Bureau of the Census, Current Housing Reports, Annual Housing Survey: 1983, Part C, Financial Characteristics of the Housing Inventory 259 (1983).

income housing market therefore warrants special and targeted regulation. In a modest and limited way, the San Jose ordinance in questions proposes to do just that.[10] By considering the income of the tenant in ascertaining the reasonableness of a proposed rent increase, a hearing officer can develop some understanding of the segment of the housing market involved and of the relative bargaining position of the parties. Thus, for example, if a landlord is seeking to raise rents solely on the basis of rent increases obtained in other units in a complex,[11] the fact that the tenant is a senior on a fixed income with no other

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[10] The ordinance only requires a hearing officer in reviewing the reasonableness of a rent increase (which is otherwise not cost justified or justified by the rate of return on investment) to "consider" a low income status of a tenant. § 5703.29, San Jose, Cal., Municipal Code § 17.23.450 (1986). Because this facial challenge arose prior to the City's Advisory Commission on Rents could issue interpretive regulations on the subject, it is as yet unclear what conclusions the 'consideration' will involve.

[11] Such an increase is now possible under § 5703.28(c)(6). This example presumes the landlord has no other justification based upon increased costs or inadequate return on investment.

options in the housing market can and should be considered in establishing a rent increase "reasonable under the circumstances."

Consideration of the hardship to the tenant is clearly a rational government response to the particular character of local housing markets, "correcting their failures and aiding their victims." *Fisher v. City of Berkeley*, 106 S. Ct. 1045, 1048 (1986). The hardship provision logically tailors the rigorousness of the rent review process to reflect the areas of greatest need. Furthermore, to the extent the ordinance preserves the tenancies of low-income residents, the policy stabilizes existing neighborhoods and mitigates trends toward increasing age and racial segregation in housing. *See* Weitzman, *Economics & Rent Regulation: A Call For a New Perspective*, 13 N.Y.U. Rev. L. & Soc. Change 975, 985-86 (1985); LeGates & Hartman. *Gentrification-Caused Displacement*, 14 Urb. Law. 31, 40-41, 53-54 (1982). Whether in practice the San Jose Ordinance goes far enough in meeting these important objectives remains yet to be seen.

The City of San Jose has determined that rent control is an appropriate economic policy in response to the exigencies of its housing market. The City has further determined that alleviating tenant hardship, along with preventing excessive rents and ensuring a fair return, should be a specific goal of its rent control ordinance. Under the circumstances, the alleviation of tenant hardship is not an arbitrary or irrational goal; it is a logical response to severe housing shortages and excessive rents within the local housing market. Alleviating tenant hardship is, therefore, a legitimate legislative purpose in the context of the San Jose rent control ordinance.

III

THE TENANT HARDSHIP PROVISIONS REGULATE PRICES WITHOUT TAKING PROPERTY FOR PUBLIC USE

The fifth amendment, made applicable to state and local government by the fourteenth amendment, *Chicago, Burlington & Quincy R.R. Co. v. Chicago*, 166 U.S. 226 (1896), prohibits the taking of private property for public use without just compensation. U.S. Const. amend. V, cl. 5. Appellants contend that the San Jose rent control ordinance's tenant hardship provisions force a taking because they reduce a landlord's potential rent increase below a reasonable level.[12] Tenant hardship can reduce a proposed rent increase, but appellants' argument carries insufficient weight to strike down the tenant hardship provisions on fifth amendment grounds. On its face, the San Jose rent control ordinance guarantees a reasonable return to landlords and does not confiscate property for public use.

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[12] Appellants rely in part on the distinction between government's acting in an "arbitral capacity" and its acting in an "enterprise capacity" to support a fifth amendment violation by the San Jose ordinance. *See* Sax, *Takings and the Police Power*, 74 Yale L.J. 36 (1964). Appellants contend that because alleviating the financial hardship of low-income tenants is a public function comparable to the building of roads or the maintenance of public waterways, the City of San Jose is acting in its enterprise capacity. The tenant hardship provisions violate the fifth amendment, therefore, because the ordinance requires landlords to shoulder the City's function of "providing for and maintaining the material plant . . . ." *Id*. at 62.

To the extent that the arbitral/enterprise distinction is useful, it is clear that alleviating tenant hardship is an arbitral rather than enterprise function. As Professor Sax himself writes: "Typically in [the arbitral] function . . . as between tenant and landlord [government] may adjust prices or impose certain standards for health and safety." *Id*. at 62-63. By weighing tenant hardship with landlord costs, the ordinance adjusts rents to strike a balance between landlord and tenant interests. Thus the City acts in its arbitral capacity by "mediat[ing] the disputes of various groups within the society, and . . . resolv[ing] the conflict among competing and conflicting alternatives." *Id*. at 62.

This Court has not articulated a specific test to determine when a governmental regulation takes private property, but the "essentially ad hoc, factual inquir[y]" involves the weighing of several factors, including the character of the regulation, the economic impact on the claimant, the relative interference with investment-backed expectations, as well as the promotion of the public welfare by the government's action. *Penn Central Transp. Co. v. City of New York*, 438 U.S. 104, 124 (1978).

Based on the Court's previous cases, the tenant hardship provisions may be analyzed in any of three ways: (1) as an economic regulation case in which government adjusts rates or prices to stabilize an economic market, *see, e.g., Federal Communications*

Comm'n v. Florida Power Corp., 107 S. Ct. 1107 (1987); *Permian Basic Area Rate Cases*, 390 U.S. 747 (1968); (2) as a land use regulation case in which the value or usefulness of property is diminished by regulatory action not involving the physical invasion of the property, *see, e.g., Keystone Bituminous Coal Ass'n v. DeBenedictis*, 107 S. Ct. 1232 (1987); *Agins v. City of Tiburon*, 447 U.S. 255 (1980); *Penn Central Transp. Co. v. City of New York*, 438 U.S. 104 (1978); or (3) as a physical occupation case in which the government physically intrudes upon private property either directly or through the authorized action of others, *see, e.g., Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982); *Kaiser Aetna v. United States*, 444 U.S. 164 (1979).[13]

Because the procedures established by the San

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[13] "A 'taking' may more readily be found when the interference with property can be characterized as a physical invasion by government . . . than when interference arises from some public program adjusting the benefits and burdens of economic life to promote the common good." Penn Central Transp. Co. v. City of New York, 438 U.S. 104, 124 (1978) (citation omitted).

Jose rent control ordinance are essentially price controls that set a ceiling on a landlord's annual rent increase, an economic regulation framework is appropriate to analyze the tenant hardship provisions. Under the ordinance's balancing scheme, a landlord proposes an increase based on costs, debt service, and other factors; a hearing officer then sets a reasonable rent increase based on the landlord's proposed figure and any mitigating tenant hardship. Thus the procedures are analogous to forms of economic regulation such as rate setting rather than to land use regulations[14] or to physical invasions of property.[15]

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[14] The tenant hardship provisions still would comply with the fifth amendment under a regulatory use analysis. The Court has held that a land use regulation will not cause a taking if it advances a legitimate governmental interest and does not substantially deprive an owner of viable use of the property. Nollan v. California Coastal Comm'n, 55 U.S.L.W. 5145 (1987). The tenant hardship provisions advance a legitimate governmental interest--the alleviation of undue hardship on tenants. See supra Part II. And, the tenant hardship provisions do not deprive a landlord of the economic use of his property: On its face, the ordinance always guarantees a reasonable return. See supra Part I.B.

[15] Appellants' suggestion that the San Jose rent control ordinance forces a physical taking is completely misguided. "This Court has consistently affirmed that States

Cf. Federal Communications Comm'n v. Florida Power Corp., 107 S. Ct. 1107 (1987) (physical invasion per se rule not applicable to rate regulation involving use of utility poles).

Any economic regulation may subject individual investors to decreases in their expected profit, but a taking does not occur unless that regulation causes a serious economic loss: "The fixing of prices, like other applications of the police power, may reduce the value of the property which is being regulated. But the fact that the value is reduced does not mean that

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have broad power to regulate housing conditions in general and the landlord-tenant relationship in particular without paying compensation for all economic injuries that such regulation entails. . . . So long as these regulations do not require the landlord to suffer the physical occupation of a portion of his building by a third party, they will be analyzed under the multifactor inquiry generally applicable to nonpossessory governmental activity." Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419, 440 (1982) (citations omitted). Certainly, the price controls established by the tenant hardship provision do not physically invade a landlord's property. And, the ordinance's eviction limitations, unchallenged in the courts below, simply assure tenants that they can exercise their rights under the ordinance without fear of retaliation or circumvention of the ordinance by landlords. As long as they do not violate antidiscrimination laws, landlords are always free not to rent to tenants who may fall under the hardship provisions.

the regulation is invalid." *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 601 (1944); *see Permian Basin Area Rate Cases*, 390 U.S. 747, 769 (1968) (regulation of prices "may, consistently with the Constitution, limit stringently the return recovered on investment, for investors' interests provide only one of the variables in the constitutional calculus of reasonableness").

The tenant hardship provisions can reduce a landlord's potential rent increase, but appellants assume that the reduction comes at the expense of a reasonable return. Tenant hardship lowers a landlord's expectation of profit, but it does not allow rent increases to dip below a reasonable level. *See supra* Part I.B. In combination with several other variables, tenant hardship is designed to set a rate below market level but at or above a constitutional minimum.

IV

THE TENANT HARDSHIP PROVISIONS DO NOT REQUIRE LANDLORDS TO SUBSIDIZE TENANTS

Appellants characterize any decrease in a landlord's annual rent increase due to tenant hardship as a forced subsidy. Appellants attack tenant hardship because the challenged provisions supposedly extirpate part of a landlord's reasonable return and place it in the hands of a hardship tenant. In a sense, landlords under all rent control ordinances "subsidize" tenants: Because rent control reduces rents below the market rate, tenants do not have to pay the difference between the landlord's fair return and the market level. *See Pennell v. City of San Jose*, 42 Cal. 3d 365, 372, 721 P.2d 1111, 1116, 228 Cal. Rptr. 726, 731 (1986). However, appellants misuse the term "subsidy" when referring to a reduced rent increase under the San Jose ordinance. The tenant hardship provisions do not require landlords to finance the housing costs of hardship tenants by sacrificing an otherwise reasonable return. Instead, the provisions use tenant hardship as an index to set a ceiling on a proposed rent increase and to maintain both a fair return and an affordable increase.

Appellants rely on *Property Owners Association v. Township of North Bergen*, 74 N.J. 327, 378 A.2d 25 (1977), to support an unconstitutional subsidy in this case. In *North Bergen*, the New Jersey Supreme Court held unconstitutional a rent control ordinance that precluded rent increases for low-income, elderly tenants. Under the North Bergen ordinance, landlords normally could impose upon tenants a fifteen percent annual rent increase. Senior tenants, defined as individuals aged 65 or over with household incomes below $5000, had their rents frozen and were excluded from the annual rent increases. If, after other tenants' rents had been raised, a landlord were entitled to additional funds, the Township would pay the landlord a subsidy up to ten percent of the senior tenant's rent.

The New Jersey Supreme Court struck down the ordinance as unconstitutionally confiscatory because

landlords with senior tenants would be deprived of rents to which they were constitutionally entitled. *Id.* at 336-37, 378 A.2d at 29-30. Landlords would be required to subsidize senior tenants to the extent that non-senior tenants and the Township could not make up the difference between the rent charged to a senior tenant's apartment and the landlord's other apartments.

Like the North Bergen ordinance, the San Jose ordinance attempts to assist members of society who need special protection from hardship and high rents. However, the San Jose ordinance is distinguishable from the North Bergen ordinance in two important ways. First, the North Bergen ordinance froze rents and offered no type of set increase to landlords with senior tenants; the San Jose ordinance guarantees all landlords an automatic eight percent annual increase. Second, the North Bergen ordinance was found not to ensure a fair return on the landlord's property;[16] the San Jose ordinance states explicitly that hearing officers shall "tak[e] into consideration that the purpose of [the] Ordinance is to permit landlords a fair and reasonable return on the value of their property" whenever they set a rent increase. Section 5703.28, San Jose, Cal., Municipal Code § 17.23.440 (1986). Thus, although appellants correctly state that *North Bergen* stands for the proposition that landlords cannot be required to subsidize a particular class of tenants at the expense of a reasonable return, the San Jose rent control ordinance passes the *North Bergen* test because it always guarantees a reasonable return. *Cf. Hutton Park Gardens v. Town Council*, 68 N.J. 543, 350 A.2d 1 (1975).

Landlords with hardship tenants may face lower profit levels than landlords without hardship tenants under the San Jose rent control ordinance. Still, the "subsidy" borne by landlords with hardship tenants is not unconstitutional. The takings clause is not violated because the ordinance ensures a reasonable return to landlords, even if their rent increase is lower than the increase for an identically situated landlord without hardship tenants. *See supra* Part III. Moreover, equal protection is not violated because some landlords may receive a lower rent increase than other landlords. *See Cotting v. Kansas City Stock Yards Co.*, 183 U.S. 79, 111 (1901). A landlord's primary concern under the ordinance's balancing scheme is the safeguarding of a reasonable return; once this goal is achieved, any further differentiation is no longer onerous. Because the tenant hardship provisions serve the important governmental purpose of protecting tenants in the San Jose housing market and because the provisions do not require landlords with hardship tenants to bear an overly heavy burden, landlords receive equal protection under the law. *See supra* Part II.B.

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[16] The ordinance could have provided a reasonable return if applied to a landlord whose fair return was met by other tenants' increases or the Township's subsidy. The New Jersey Supreme Court chose, however, to hold that as long as the ordinance offered the possibility of not providing a reasonable return, it would be unconstitutional.

CONCLUSION

Urban housing shortages and high rents present serious problems for low-income tenants. Rent control has become a common, albeit controversial, solution. Although opponents challenge it as unwise and inefficient, rent control is often the only way to ensure affordable housing for urban tenants.

In the instant case, the Court is not asked to resolve an ongoing debate by passing judgment on the wisdom of rent control as a public policy. Nor is the Court required to decide the constitutionality of nonemergency rent controls in general. Rather, the Court must decide whether a central goal of rent control--alleviating tenant hardship--can be codified in a specific section of an ordinance and still pass constitutional muster.

The tenant hardship provisions of the San Jose rent control ordinance translate into concrete policy the protection of indigent and low-income tenants from

excessively high rents. Without question, the tenant hardship provisions can diminish a landlord's proposed rent increase; however, such a diminution does not imply constitutional infirmity. The San Jose ordinance guarantees a reasonable return in all cases. And while landlords with hardship tenants may obtain lower rent increases, the underlying goal of easing tenant hardship justifies a policy that is rational, nonarbitrary, and unburdensome. The San Jose rent control ordinance's tenant hardship provisions are constitutional, and the decision of the California Supreme Court should be affirmed.

Respectfully submitted,

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AMICUS CURIAE

BRIEF

(24)

Supreme Court, U.S.
FILED
JUL 31 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-753

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

RICHARD PENNELL and TRI-COUNTY APARTMENT HOUSE OWNERS ASSOCIATION,
Appellants,

v.

CITY OF SAN JOSE and CITY COUNCIL OF THE CITY OF SAN JOSE,
Appellees.

On Appeal from the Supreme Court of the State of California

BRIEF AMICUS CURIAE OF THE NATIONAL INSTITUTE OF MUNICIPAL LAW OFFICERS IN SUPPORT OF APPELLEE, CITY OF SAN JOSE

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IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1986

NO. 86-753

RICHARD PENNELL and TRI-COUNTY APARTMENT HOUSE OWNERS ASSOCIATION,

Appellants,

v.

CITY OF SAN JOSE and CITY COUNCIL OF THE CITY OF SAN JOSE,

Appellees.

On Appeal from the Supreme Court
of the State of California

BRIEF AMICUS CURIAE OF THE NATIONAL INSTITUTE OF MUNICIPAL LAW OFFICERS IN SUPPORT OF APPELLEES

INTEREST OF THE AMICUS CURIAE

This brief amicus curiae is filed pursuant to Rule 36 of this Court on behalf of the more than 1,900 local governments that are members of the National Institute of Municipal Law

Officers (NIMLO). Both parties have consented to the filing of this brief and their letters of consent have been lodged with the Clerk of the Court.

NIMLO is a national organization comprised of municipalities and local government units. NIMLO is operated through the chief legal officers of its members, variously called city attorney, county attorney, city solicitor, corporation counsel, law director, and other titles. The Appellee, City of San Jose, is a member of NIMLO.

This brief is signed by the municipal attorneys constituting the governing body of NIMLO, both on behalf of NIMLO and as the authorized law officer of their particular municipalities. The local government attorneys who operate NIMLO are

responsible for advising their municipal governments on the most effective lawful methods for promoting the public welfare in their jurisdictions. These attorneys also represent their municipalities in litigation resulting from the implementation of municipal regulations, including rent control ordinances.

NIMLO believes that the San Jose rent control ordinance challenged in this case is a valid exercise of the City's broad municipal police power. The ordinance is designed to strike a fair balance between the interests of rental property owners and their tenants in order to promote important governmental objectives. Should this Court find the ordinance unconstitutional, local governments will be seriously undermined in their ability to impose reasonable regulations on housing developers and other private business interests when the public welfare demands. Accordingly, NIMLO has a significant interest in the issues raised by this case.

STATEMENT OF CASE

Amicus adopts the statement of the case and the facts as presented by Appellee, City of San Jose.

SUMMARY OF ARGUMENT

Appellants' taking claim is not ripe for review because it fails to satisfy the finality requirements articulated by the Court. Resolving the taking issue requires analysis of the specific economic effects of a challenged regulation. This case rests on speculation about future

governmental actions and, consequently, any analysis would be purely hypothetical.

Even if the Court decides that this case is ripe for review, Appellants' allegations do not establish the unconstitutionality of the City's rent control ordinance under the factors identified by the Court as relevant.

First, the physical invasion concepts developed by the Court are not applicable to a mere regulation of property. The challenged ordinance consists of regulation rather than physical occupation and was intended not to benefit the City but to prevent harm to the public.

Second, the ordinance clearly permits Appellants the reasonable beneficial use of their property as it guarantees the City's landlords a fair rate of return. Evidence of a tenant's financial hardship is permitted only when a proposed rent increase is in excess of the guaranteed minimum return. Moreover, tenant hardship is but one of several relevant factors that must be considered, weighed, and balanced in determining whether a proposed rent increase is reasonable under the circumstances. This rent-setting scheme fairly accommodates and protects the interests of both landlords and tenants.

Third, the tenant hardship provisions are substantially related to the City's valid governmental objectives. They clearly further the City's interest in preventing landlords from exploiting a housing shortage by charging excessive and unreasonable rents.

In addition, sound public policy considerations support the constitutionality of the ordinance. In enacting this regulation, the City was exercising its police power in response to a serious threat to the health and welfare of the community. If this ordinance is held unconstitutional, local governments will undoubtedly be undermined in their ability to fashion appropriate legislative remedies to the complex modern problems of our society. In judging the validity of this ordinance, the Court should be mindful of the fundamental nature of the police power and its vital role in regulating private activity that may endanger the public interest.

ARGUMENT

I. APPELLANTS' TAKING CLAIM IS NOT RIPE FOR ADJUDICATION.

Under the provisions of the San Jose rent control ordinance, a landlord who desires a rent increase in excess of the guaranteed fair rate of return is entitled to a hearing at which a Hearing Officer must weigh a number of relevant factors in determining a rent increase that would be "reasonable under the circumstances" (§5703.28(c)).[1] Appellants have never invoked this hearing process, yet they allege that application of the tenant hardship provisions of the ordinance (§§5703.28(c)(7) and 5703.29) will effect a taking of their property in violation of the just compensation clause of the Fifth Amendment (Brief for Appellants at 23).[2]

Appellants' facial challenge to the San Jose ordinance is premature. This Court has repeatedly held that regulatory taking claims are not ripe for review until the responsible administrative agency "has reached a final decision regarding the application of the regulations to the property at issue." Williamson County Regional Planning Comm'n v. Hamilton Bank, 473 U.S. 172, 186 (1985). This ripeness requirement "is compelled by the very nature of the inquiry required by the Just Compensation Clause." Id. at 190. Because the question of when a governmental regulation constitutes a taking depends on whether the regulation "goes too far," Pennsylvania Coal Co. v. Mahon, 260 U.S. 393, 415 (1922), it is crucial to first determine "how far the regulation goes." MacDonald, Sommer and Frates v. Yolo County, 477 U.S. ______, 106 S.Ct. 2561, 2566 (1986).[3]

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[1] Citations to section numbers refer to sections of San Jose, Cal., Municipal Ordinance 19696 (1979).

[2] Appellants also attack the ordinance on due process and equal protection grounds. We have chosen to address only the taking challenge to

The importance of the ripeness doctrine is well-illustrated by the case at bar. Judicial review of Appellants' taking claim would require

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the ordinance because of the potential impact of that particular issue on local governments nationwide.

[3] MacDonald is one of several cases in which the Court has refused to decide a taking claim because the claim was not ripe for review. See Williamson County, 473 U.S. at 172; San Diego Gas and Electric Co. v. City of San Diego, 450 U.S. 621 (1981); Agins v. City of Tiburon, 447 U.S. 255 (1980).

this Court to speculate as to how the challenged provisions of the City's ordinance might be applied in an actual case. Since the City has wisely allowed for the consideration of a number of variables in setting rents under the administrative hearing process, it would be nearly impossible, and entirely inappropriate, for the Court to anticipate how a Hearing Officer might rule. Indeed, a decision by a Hearing Officer to approve a landlord's proposed rent increase would vitiate the constitutional issues Appellants now raise.

Without specific facts before the Court as to how the ordinance will operate in a given case, no concrete controversy is presented for adjudication. Appellants' taking claim fails for this reason alone.

II. EVEN IF THIS COURT REACHES THE TAKING ISSUE, THE SAN JOSE RENT CONTROL ORDINANCE DOES NOT EFFECT A TAKING OF APPELLANTS' PROPERTY.

The Supreme Court has long-recognized the difficulty in defining when governmental regulation amounts to an unconstitutional taking of property. See Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1005 (1984). In evaluating taking claims, the Court has relied essentially on an ad hoc, case-by-case factual inquiry. The factors of particular significance to that inquiry fall generally under two headings -- the economic impact on the claimant and the character of the governmental action. See Penn Central Transp. Co. v. City of New York, 438 U.S. 104, 124 (1978). In addition to these familiar elements of the taking equation, the Court has recently held that a taking may also be found if

there is no direct nexus between a legitimate governmental purpose and the challenged regulation. Nollan v. California Coastal Comm'n, 55 U.S.L.W. 5145, 5148 (U.S. June 26, 1987).

We submit that the San Jose rent control ordinance is a constitutionally valid police power measure which easily satisfies the various tests developed for resolving the taking issue.

A. The Ordinance Permits Appellants The Reasonable Beneficial Use Of Their Property And Assures Them A Fair Rate Of Return.

If this Court determines that Appellants' case is ripe for review, then the sole issue presented is whether the rent control ordinance is unconstitutional per se:

> [T]he only issue properly before... this Court, is whether the "mere

> enactment" of the [ordinance] constitutes a taking. See Agins v. Tiburon, 447 U.S. 255, 260 (1980). The test to be applied in considering this facial challenge is fairly straightforward. A statute regulating the uses that can be made of property effects a taking if it "denies an owner economically viable use of his land..." Agins v. Tiburon, supra, at 260; See Penn Central Transp. Co. v. New York City, 438 U.S. 104 (1978).

Hodel v. Virginia Surface Mining and Reclamation Ass'n, 452 U.S. 264, 295-96 (1981).

Under this standard of review, the fact that the ordinance might deprive Appellants of the most profitable use of their property does not constitute a taking. Andrus v. Allard, 444 U.S. 51, 66 (1979); Penn Central Transp. Co. v. City of New York, 438 U.S. 104, 124 (1978); Goldblatt v. Town of Hempstead, 369 U.S. 590, 592 (1962). It is clear that even severe economic impact will not effect a taking so long as any "reasonable beneficial use" of the

property remains. Penn Central, 438 U.S. at 135-38. See, e.g., Village of Euclid v. Ambler Realty Co., 272 U.S. 365 (1926) (75% diminution in value); Hadacheck v. Sebastian, 239 U.S. 394 (1915) (87% diminution in value).

The "reasonable use" inquiry must be made while viewing the property as a whole. Decisions of the Court reflect this principle for they speak of property as a "bundle of rights." See Andrus v. Allard, 444 U.S. 51, 65-66 (1979). Where an exercise of the police power is concerned, and "where an owner possesses a full 'bundle' of property rights...," a limitation placed on "one strand of the bundle" does not constitute a taking. Id. at 65-66. In Andrus, the Court did not find an unconstitutional taking when government regulation prohibited sale of an owner's property because the owners "retain[ed] the rights to possess and transport their property, and to donate or devise" it. *Andrus*, 444 U.S. at 66.

In the present case Appellants undeniably enjoy the right to use their property in a number of reasonably beneficial ways. The ordinance does not affect their right to possess or sell their property, or, more importantly, their right to draw a fair rental income. The sole economic impact of the ordinance on Appellants will be to prevent them from setting rents at an unreasonably or excessively high level. But, as already discussed, there is no constitutional impediment to a regulation which merely prohibits the most profitable use of property.

Moreover, the San Jose ordinance assures Appellants a fair and

reasonable return on the value of their property and thus cannot fairly be characterized as confiscatory.[4] The ordinance entitles a landlord to a rent increase of 8% annually, or 5% of the current rent plus pass-through costs, whichever is *highest*. (§§5703.2, 5703.28(a) and (b)). Only when a landlord desires an increase in excess of that amount is a Hearing Officer permitted to consider tenant hardship (§5703.28(c)). In addition, the ordinance contains no limit on the amount of an increase which may be granted. The Hearing Officer is required simply to balance and weigh the seven relevant factors listed in §5703.28(c), including tenant hardship information, in determining a reasonable rent increase over and above the guaranteed fair return.

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[4] A rent control ordinance is facially unconstitutional when its terms are so restrictive that there is no possibility of a reasonable return. *Birkenfeld v. City of Berkeley*, 17 Cal. 3d 129, 165, 130 Cal. Rptr.465 496, 550 P.2d 1001, 1027 (1976); *Hutton Park Gardens v. Town Council*, 68 N.J. 543, 568, 350 A.2d 1,14-16 (1975). As with all price-setting schemes, as long as the results reached are fair, the methods used are irrelevant. *See Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1943).

Furthermore, nothing in the ordinance prevents the Hearing Officer from granting a proposed rent increase in spite of resulting tenant hardship. A rent increase is not in any way dependent on tenant hardship since that is only one of several factors to be considered.

It simply cannot be shown that the tenant hardship provisions of the ordinance will operate in every case to

deny landlords a fair rate of return. Absent such evidence, Appellants have failed to establish that the ordinance effects an unconstitutional taking of property.

B. The Character Of The Ordinance Does Not Support A Taking Claim.

In addition to economic impact, the character of the government's action is critical in a taking analysis. Keystone Bituminous Coal Ass'n v. DeBenedictis, 480 U.S. ____, 107 S.Ct. 1232, 1233 n. 18 (1987). It is settled that a taking can much "more readily be found when the interference with property can be characterized as a physical invasion by government, See, e.g., United States v. Causby, 328 U.S. 256 (1946), than when interference arises from some public program adjusting the benefits and burdens of economic life to promote the common good." Penn Central Transp. Co. v. City of New York, 438 U.S. 104, 124 (1978). See also Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419, 430 (1982) (confirming the distinction between a permanent physical occupation, a physical invasion short of an occupation, and a mere restriction on the use of property).

In instances where the interference with property amounts to a physical invasion, the government often acts in its "enterprise capacity" to acquire assets, or in some other way seeks to directly benefit from the interference.[5] The Court has almost uniformly found such governmental actions to be takings. See,e.g., Armstrong v. United

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[5] Sax, Takings and the Police Power, 74 Yale L.J. 36,63 (1964).

States, 364 U.S. 40, 49 (1960) (government action held a taking where the government was the "direct, positive beneficary" of the complete destruction of a materialman's lien); United States v. Causby, 328 U.S. 256, 262-63 n.7 (1946) (low overflights of military aircraft destroyed a chicken farm and also "used part of it").

The physical invasion concepts developed by the Court are not applicable to the case at bar. Here, the City of San Jose has acted to promote the health and welfare of its citizens through a rent control ordinance which seeks to accommodate the interests of both landlords and tenants. Such action benefits not the government acting in its enterprise capacity, but the public as a whole.

Moreover, Appellants' contention that the ordinance singles them out to suffer an undue burden ignores the fact that governmental regulations often adjust the rights of competing private interests in order to promote significant public welfare goals. This process necessarily places limits on the use or economic exploitation of private property, but it does not state a cause of action under the just compensation clause.

> [U]nder the Act, the Government does not physically invade or permanently appropriate any of the employer's assets for its own use...[The] interference with the property rights of an employer arises from a public program which adjusts the benefits and burdens of economic life to promote the common good and, under our cases, does not constitute a taking requiring Government compensation.

Connolly v. Pension Benefit Guarantee Corp., 475 U.S. _____, 106 S.Ct. 1018, 1026 (1986)(citations omitted).

In sum, there is nothing in the Constitution or in the relevant decisions of this Court which would support a claim that the mere assertion of regulatory jurisdiction by San Jose constitutes a taking. See,e.g., United States v. Riverside Bayview Homes, 474 U.S. 121 (1985).

C. The Tenant Hardship Provisions Of The Ordinance Substantially Further A Legitimate Governmental Purpose.

In its most recent pronouncement on the taking issue, this Court held that in order for a governmental restriction on private property to survive scrutiny under the just compensation clause, there must be a close relationship between the restriction at issue and a legitimate governmental objective. Nollan v. California Coastal Comm'n, 55 U.S.L.W. 5145, 5148 (U.S. June 26, 1987). Unless such a direct nexus exists, the "restriction is not a valid regulation, but 'an out-and-out plan of extortion.'" Id. (citations omitted).

The tenant hardship provisions of the San Jose rent control ordinance easily pass constitutional muster under this standard of review, particularly given the limited scrutiny of this Court into such questions. See Goldblatt v. Hempstead, 369 U.S. 590, 595-96 (1962). The challenged provisions were enacted in response to a threat posed to the public welfare from the combined effects of high inflation, a severe housing shortage, and skyrocketing rent increases. In order to prevent Appellants from exploiting this situation, the City decided that evidence of tenant hardship would have a place in

determining a reasonable rent increase in excess of the fair return guaranteed to all landlords. Such action is a classic use of the police power and substantially furthers the City's goal of alleviating the unwarranted financial burden on tenants caused by excessive and unreasonable rent increases. As the courts have consistently held, "prevention of the exploitation of shortages of available housing by precluding excessive rent is a legitimate governmental purpose." Cotati Alliance for Better Housing v. City of Cotati, 148 Cal. App. 3d 280, 292-93, 195 Cal. Rptr. 825, 833 (1983).

Since it is apparent that the provisions at issue are substantially related to the City's legitimate legislative aim, it would seem that Appellants' real objection is that San

Jose has chosen to meet its needs through rent control rather than through alternative means less burdensome to Appellants. Clearly, the proper forum for this argument is the San Jose City Council and not the U.S. Supreme Court, for this Court has unequivocally abandoned the practice of second-guessing the wisdom of particular legislative actions. Ferguson v. Skrupa, 372 U.S. 726, 731-32 (1963). It is sufficient under the Constitution that the ordinance is a valid means of achieving important governmental ends.

III. IF THIS ORDINANCE IS HELD TO CONSTITUTE A TAKING, THE ABILITY OF LOCAL GOVERNMENTS TO REGULATE UNDER THE POLICE POWER WILL BE CRIPPLED.

The taking question before this Court involves an issue of vital public

importance--the role of the police power under a democratic system of government. The Court has often recognized the fundamental nature of the police power and its vital role in a rapidly changing society:

> [P]roblems have developed, and constantly are developing, which require, and will continue to require, additional restrictions in respect of the use and occupation of private land in urban communities. Regulations, the wisdom, necessity and validity of which, as applied to existing conditions, are so apparent that they are now uniformly sustained, a century ago, or even half a century ago, probably would have been rejected as arbitrary and oppressive.

Village of Euclid v. Ambler Realty Co., 272 U.S. 365, 386-87 (1926).

To hold the San Jose ordinance unconstitutional merely because it imposes a burden on some which is not shared by others would seriously undermine the ability of local governments to enact the innovative legislation needed to meet the changing conditions of urban life. Not only would other rent control regulations be jeopardized if this Court strikes down the challenged ordinance, but so would a host of similar legislative initiatives.

For example, condominium conversion regulations often require the condominium converter to assist non-purchasing tenants in their search for new housing and to pay tenant relocation costs.[6] Similarly, inclusionary zoning ordinances operate under the police power to require housing developers to sell or rent a certain percentage of the units in new housing developments to low or middle-income individuals.[7] If this Court accepts Appellants' taking argument, these and other regulatory actions would be subject to constitutional challenge by claimants who could allege a "burden" on them that should be spread among the public at large. Such a result would strike at the very heart of the police power and engender even more confusion among municipal officials currently struggling to define the lawful parameters of governmental regulations that restrict private property interests.

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[6] *See* D.C. Code Ann. §45-1571, §§45-1581 to 1585, 45-1601 to 1657 (1981 and Supp. 1984); Los Angeles, Cal., Code §47.06 (D)(1)(a)(4) (1979); San Francisco, Cal., Code §1392 (a)(1979). On this subject generally, see Judson, *Defining Property Rights: The Constitutionality of Protecting Tenants From Condominium Conversion*, 18 Harv. C.R.- C.L. L.Rev. 179 (1983).

[7] *See generally*, Kleven, *Inclusionary Ordinances--Policy and Legal Issues in Requiring Private Developers To Build Low Cost Housing*, 21 U.C.L.A. L. Rev. 1432 (1974).

We contend that the San Jose ordinance finds a proper balance between the needs of the community, as defined by its duly elected representatives, and the rights of private property owners. Traditionally, this Court has proceeded with deference to the breadth and expansiveness of the police power. See, e.g., Berman v. Parker, 348 U.S. 26 (1954). We urge the Court to recognize in this case, as it has in the past, that safeguarding the welfare of the public necessitates new and creative applications of the police power:

> It is to be remembered that we are dealing with one of the most essential powers of government, one that is the least limitable. It may, indeed, seem harsh in its exercise, usually is on some individual, but the imperative necessity for its existence precludes any limitation upon it when not exerted arbitrarily... There must be progress, and if in its march private interests are in the way, they must yield to the good of the community.

Hadacheck v. Sebastian, 239 U.S. 394, 410 (1915).

CONCLUSION

Appellants' speculative allegations fail to establish a justiciable controversy under the just compensation clause. Even if the Court finds that Appellants' claim is ripe for review, the San Jose rent control ordinance is not a confiscatory regulation. To the contrary, it is a valid and reasonable exercise of the City's municipal police power.

We therefore ask the Court to affirm the decision of the California Supreme Court upholding the constitutionality of the San Jose ordinance.

Respectfully submitted,

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